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ABSTRACT

The 1997-98 Asian financial crisis and its aftermath have brought to light a number of crucial economic lessons. This curriculum unit focuses on some of the purported causes of the crisis, the workings of the International Monetary Fund, and the general nature of economies affected by financial turmoil. Lesson 1, "A Story of Boom and Bust in Asia, 1997-98," introduces basic economic terminology and exchange market mechanisms; a class newspaper activity directs students to investigate the Asian crisis on the Internet. Lesson 2, "The International Monetary Fund (IMF)," focuses on the history and responsibilities of the IMF; handouts for teacher and students describe a classroom team quiz activity. Lesson 3, "A Glance at the Crisis," consists of two parts in which students can apply what they have learned from the first two lessons; part 1 is a role play in which students divide into groups representing 10 different East Asian countries and the IMF Executive Board, and in part 2 all groups participate in a discussion that simulates the IMF country evaluation process. (BT)

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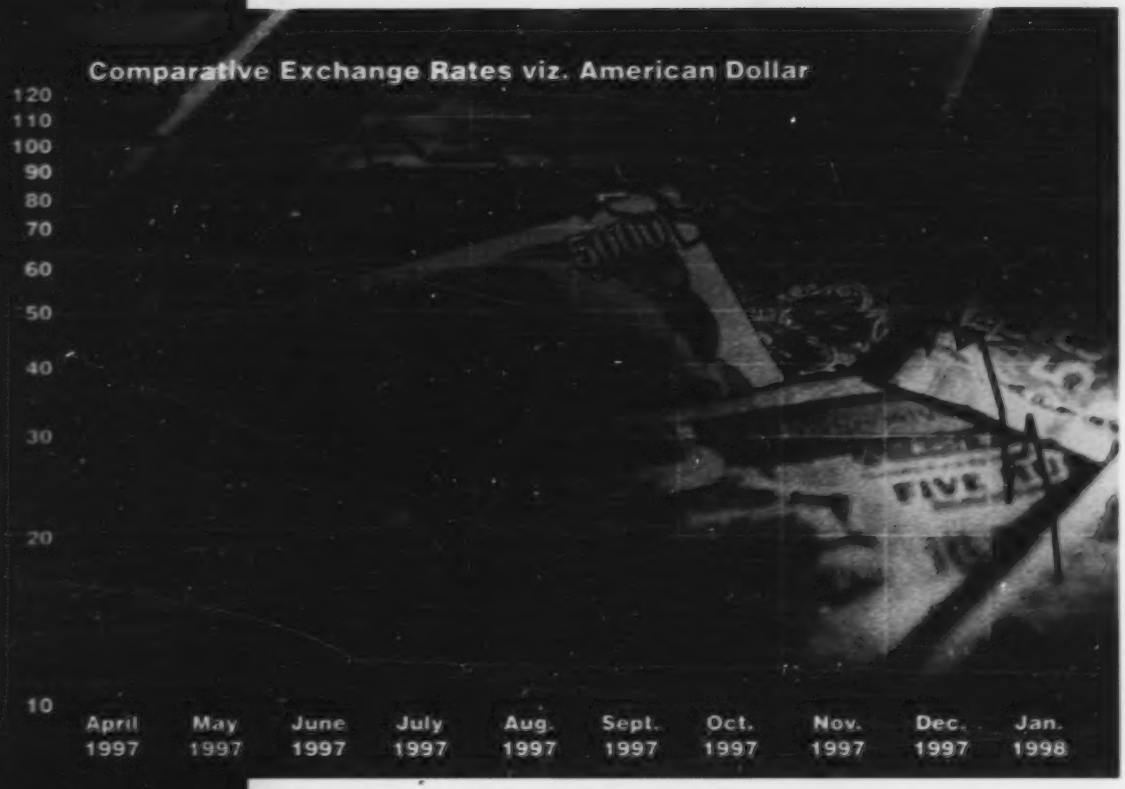
Contagion in the East

A Look at the 1997-98 Asian Financial Crisis



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CONTAGION IN THE EAST
A LOOK AT THE 1997–98 ASIAN FINANCIAL CRISIS

Developed by Isadora Lee and Selena Lai
Gregory Francis and Rachel Brunette

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Unit Introduction

CONTAGION IN THE EAST:
A LOOK AT THE 1997–98 ASIAN FINANCIAL CRISIS

Rationale and Introduction to Lessons

In the years leading up to the summer of 1997, East Asia seemed to be a promising player in the global economy. Market-watchers and investors in the late 1980s would scarcely have predicted that the developing Asian countries would be fraught with economic problems a decade or so down the road. For the most part, the early hints and warning signals of an impending financial crisis went largely unheeded; this crisis surprised and caught many unprepared. Now, as the Asian economies are steadfastly recovering from the 1997–98 financial crisis, people have taken a step back to pinpoint the economic lessons. Thus, this retrospective glance becomes a useful intellectual exercise even for the new student in economics. This curriculum unit will introduce students to a handful of the basics in international economics and help them to understand the events of the 1997–98 Asian financial crisis. With this foundation, students will be better prepared to apply their knowledge of current events and appreciate the economic issues that are featured in the news every day.

For three decades from 1965 to 1996, Asia boasted an annual average growth rate of nearly 8 percent, which surpassed that of the United States and other European countries. The breathtaking speed of growth in the developing Asian economies quite impressed scholars and investors all over the world. Hong Kong, Singapore, Taiwan, and South Korea became known as the original "tiger economies" and had achieved the status of developed countries. By the 1990s, their neighbors, Thailand, Indonesia, and Malaysia were catching up. Who would have suspected that they would prove to be an unruly bunch of tiger cub economies?

While many domestic and foreign investors capitalized on the profits reaped in these rapidly thriving economies, some of their more skeptical counterparts questioned whether such impressive growth rates would be sustainable in the long run. Stock prices, real estate market values, and exchange rates were climbing at a breakneck pace. Corporations and foreign lenders were contributing to the high investment rate in the developing Asian countries. Whispers of doubt circulated as economists commented on the feverish pace of the Asian economies and the possibility of over-valued markets. These unsettling rumors seemed to go hand in hand with the growing suspicions of dubious financial dealings among banks and corporations in Thailand and Indonesia.

unit introduction

After roughly thirty years of unfettered economic growth and financial exuberance in Asia, the investment bubble finally burst. The financial excesses of the previous years had indeed been too good to be true, and the interdependence among the Asian financial markets at once became even clearer when the economic troubles spread from Thailand to its neighbors like an infectious disease.

The 1997–98 Asian financial crisis and its aftermath have brought to light a number of crucial economic lessons for everyone, not simply economists, investors, or even government leaders. In this modern global economy, it should come as no surprise that the financial crisis in East Asia even caused ripple effects in other economies as far away as Russia and Latin America. By virtue of this web of international markets and communication, economic fluctuations in Asia can affect us all in varying degrees. In *Contagion in the East*, students will familiarize themselves with various economic terms, some of the purported causes of the 1997–98 Asian financial crisis, the workings of the International Monetary Fund, and the general nature of economies affected by financial turmoil.

Lesson One introduces students to some basic economic terminology and exchange market mechanisms and presents a summary of the 1997–98 Asian financial crisis. With a general understanding of the Asian economies and the train of events leading up to the Asian financial meltdown, students will better grasp the implications of economic trends and policies covered in the news. Students will be asked questions designed to gauge their understanding of economic fundamentals. A class newspaper activity directs students to find out more about the Asian financial crisis on the Internet.

Lesson Two focuses on the history and responsibilities of the International Monetary Fund (IMF). Handouts are provided for the teacher and students to read in preparation for a classroom Team Quiz activity. The readings will introduce students to the basic objectives of the IMF. To further solidify their understanding of the IMF and form their own conclusions about its effectiveness, student groups will be asked to create a one-page brochure summarizing the key features of the IMF.

Lesson Three consists of two parts in which the students will apply what they have gleaned from the first two lessons. Part One is a role play in which students will be divided into groups representing 10 different East Asian countries and the IMF Executive Board. Each group will prepare a presentation that highlights the key economic strengths and weaknesses of the assigned countries. All groups will participate in a discussion that simulates the IMF country-evaluation process. As a final exercise, each group will be asked to present a final report on the current economic status of its designated country.

Unit Goals

Each of the activities in this curriculum unit has specific learning objectives listed. The following reflect larger goals for the unit as a whole.

In this curriculum unit, students will:

- study historical, economic, and current events in Asia relevant to the global economy
- develop a curiosity and basic understanding of Asian and world financial markets, economic causes and effects, and the IMF
- gain an awareness and conversational fluency about the domino effects of financial crises
- familiarize themselves with economic terminology and improve their ability to express opinions about current international events
- learn to work efficiently individually and in small groups to gather ideas and create a presentation

Materials

Handouts have been provided with each lesson. Permission is given to reproduce these handouts for classroom use only.

Equipment

Overhead projector, Internet access

Grade Level and Subjects

This unit is appropriate for students in Grade 12 to Community College studying advanced economics (Advanced Placement, International Baccalaureate) or contemporary world events.

Connections to Social Science Standards

Many states recommend the teaching of international economic concepts at the high school level. The *History-Social Science Framework for California Public Schools*, for example, includes international economic concepts in the Grade 12 course of study:

"... students should concentrate on the differences between intranational and international trade. They should learn about foreign exchange and how exchange rates are determined. Students should learn why nations trade internationally, and they should understand comparative and absolute advantage.

... students might review ... studies of developing nations and consider what factors, conditions, and policies help them to achieve sustained economic growth. They should apply to other nations what they have learned about supply and growth in our economy."[1]

Time and Suggested Sequence of Activities

Contagion in the East is divided into three lessons. We recommend at least 2–3 class periods for each lesson. We suggest that you teach the unit in its entirety for the most enhanced learning experience.

---

[1] History-Social Science Curriculum Framework and Criteria Committee. *History-Social Science Framework for California Public Schools: Kindergarten Through Grade Twelve*. Sacramento: California Department of Education, 1997.

Icons

For easier reference, the following icons are used throughout the unit.

Transparency

Notes to the Teacher

Small-Group Activity

Lesson One

A Story of Boom and Bust in Asia, 1997–98

Organizing Questions

- What occurred during the 1997–98 Asian financial crisis?
- What were the relationships among the government, banks, and firms in each of the countries affected by the Asian financial crisis?
- What could explain how thriving economies like those in East Asia can suddenly fall prey to severe financial crises?
- What is investment?

Introduction

Before students can fully comprehend the events of the 1997–98 Asian financial crisis, they must be armed with a fundamental economic vocabulary. This lesson will help the instructor to present a basic summary of economic principles and some key relevant aspects of foreign markets. Once they grasp these basic concepts, students can move on to more challenging aspects of the economies in Asia. As the students study this unit, they are encouraged to learn the important facts about the main East Asian countries affected by the financial crisis. The handouts and activities are geared towards giving the students a contextual understanding of the financial crisis in this region and the interconnected economies, thus enabling them to more effectively internalize and discuss issues about the global economy.

Objectives

knowledge

- to learn about the emerging East Asian economies affected by the 1997–98 Asian financial crisis and to understand a rough timeline of events
- to become familiar with basic economic terms and issues of Asian economic reform
- to understand some of the purported causes of the 1997–98 Asian financial crisis

attitude

- to recognize the inherent differences among economies in Asia
- to understand the challenges and pressures that individual Asian economies face

skill

- to identify and articulate economic problems faced by countries in a financial crisis
- to connect economic principles to actual market events in the news

lesson one

Materials

- Handout #1, *Economic Basics*
- Handout #2, *Questions About Economic Basics*
- Teacher Information Sheet, *Answer Key to Economic Basics*
- Handout #3, *Background of the Crisis*
- Handout #4, *Helpful Websites*
- Newsprint and/or an assortment of colored and white paper
- Colored markers, pens, pencils
- Scissors, glue, tape

Time

3 class periods, 2 nights of homework

Teacher Preparation

1. Make 1 copy per student of all handouts.
2. Make 1 copy per student of the Glossary (see Appendix, p. 81). In all three lessons, key definitions are included in student handouts, but you may want to provide each student with a copy of the Glossary for additional reference. The same glossary can be used for all lessons.

Procedure

1. Inform the students that they will be applying their knowledge of economics to learn about a specific seminal economic event, the 1997–98 Asian financial crisis. If you feel that the students already have a good grasp of elementary economics, you may skip Steps 2 and 3 and proceed to Step 4.

2. To gauge their understanding of fundamental economic principles, discuss current examples of demand and supply, the recent activities of the Federal Reserve, the role of interest rates, etc. Distribute Handouts #1 and #2 to each student to read and complete as homework. Or, if you choose, allow students to do this part in class.

3. Review the answers to the *Questions About Economic Basics* using the answer key provided in the Teacher Information Sheet.

4. In the following class period, divide the students into 6 groups and distribute copies of Handout #3, *Background of the Crisis*, and Handout #4, *Helpful Websites*. Assign each group 1 of the 6 parts (A-F) on Handout #3.

5. Students are responsible for reading Handout #3 in its entirety and completing the Group Task at the end of the handout. The students in each group must work together to make their newspaper page that focuses on their assigned part (A–F). Allow 2 class periods for the groups to compose their page. Encourage students to use all available resources, including the websites listed on Handout #4. These websites should help students prepare a competent and thorough presentation.

6. After the allotted time, collect all newspaper pages made by each group. If possible, assemble these pages to form a cohesive newspaper for distribution throughout the class and school.

Optional Idea and Web Challenge: If the students have access to webpage design technology or if there is a class website already available, this activity may even be adapted into a longer term class webpage project or class online newsgroup.

7. As a debriefing exercise, encourage the students to look for articles in major newspapers and magazines (*The Wall Street Journal, The New York Times, Businessweek, The Economist*, etc. between the period of August 1997 and now) about the economies in Asia. Have them write one-page summaries/reflections on these articles.

8. Use the following questions to debrief and conclude the lesson:
   - What global occurrences can influence changes in supply and demand?
   - What has happened recently with regard to the Federal Reserve and what do you think is the rationale behind the Federal Reserve Chairman's proposals?
   - How are other economies in Europe and Asia doing in relation to the United States?
   - How has the U.S. dollar been doing compared to the currencies of the various countries in Europe and Asia?

9. To prepare for Lesson Two, distribute Handout #1, *The International Monetary Fund*, to each student. (This handout can be found in Lesson Two, page 32.) Students must read this handout thoroughly for homework and come to the next class prepared for the Team Quiz.

handout #1

ECONOMIC BASICS

This unit highlights some of the main points about the 1997–98 Asian financial crisis. It might be helpful to cover a few economic basics upon which the unit is based before delving into the story of the crisis. Although a more thorough analysis of fundamental economic principles is beyond the scope of this unit, this summary of key points is useful as an introduction or for review.

Demand and Supply

Demand is the relationship between the price of a good and the quantity demanded by consumers. This relationship indicates how much of a specific good consumers are willing to purchase at a given price with standards, preferences, quality, and other factors held constant. Supply is the relationship between the price of a good and the quantity supplied by the producer. It indicates how much suppliers are willing to sell at a given price, when all other factors are held constant.

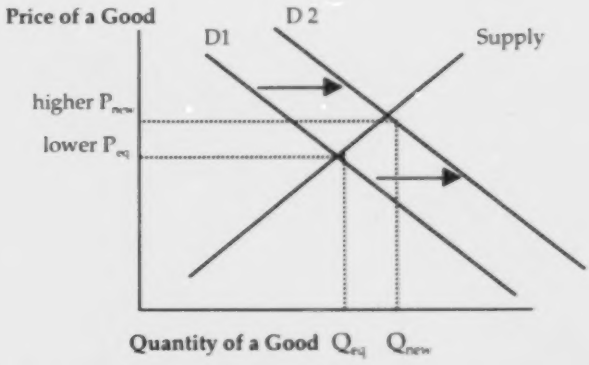
perfectly competitive market—a market in which there are many firms selling the same product; there is free entry and exit, and no firm has the power to affect the market price of a good

In a perfectly competitive market, the equilibrium price is where the demand and supply curves intersect. The demand curve has a negative slope because a person's willingness to pay for an extra unit of a normal good decreases as the price increases. You could think of demand typically being driven by prices. For a normal good, when prices increase, demand decreases; when prices decrease, demand increases.

normal good—a good for which demand increases when income rises and decreases when income falls

The equilibrium price (P_{eq}) and the equilibrium quantity (Q_{eq}) produced are determined by the intersection of the market supply and demand curves. If we hold supply constant and increase the overall level of demand, P_{eq} increases to P_{new} and Q_{eq} increases to Q_{new}. Overall demand increases due to changes in consumer preferences, natural disasters, etc. Graph 1 is a typical demand and supply graph.

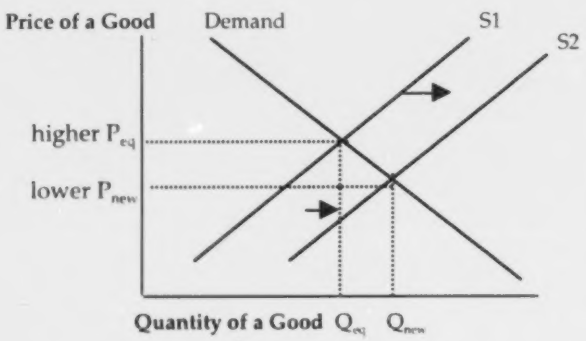
Graph 1:



As you can see, when demand increases (with all else held constant) the original demand curve D1 shifts upward to D2. The equilibrium price and equilibrium quantity that is demanded increase as well.

The supply curve is positively sloped because the higher the price that a good commands in the market, the more of it the supplier is willing to produce. If we hold demand and all other variables constant, as we increase the overall supply level in a competitive market, the original supply curve S1 shifts to the right to S2. The equilibrium price decreases as a result. Graph 2 shows what occurs.

Graph 2:



Monetary and Fiscal Policy

The economic stability of most countries is maintained by two entities: the government and the central bank. In most countries, the central bank is an institution that controls monetary policy to affect the economy. In the United States, the central bank is the Federal Reserve.

> Monetary policy refers to the entirety of actions taken by the central bank that affect the money supply and thereby interest rates, exchange rates, inflation, unemployment, and real GDP. Monetary policy is a powerful force affecting our lives. Pivotal world and national events have been convincingly attributed to it, including the Great Depression of the 1930s, the triumph of communism in China in 1949, the record economic growth of the 1950s and 1960s, the Great Inflation of the 1970s, the savings and loan crisis of the 1980s, and the election of Bill Clinton in 1992. (Taylor, 1995: 1003)

The importance of monetary policy in the United States, for example, can be seen in the way investors and even the government react to the quarterly updates made by the Chairman of the Board of Governors of the Federal Reserve. The Chairman's announcements on the state of the economy are taken rather seriously and, to a large extent, the Federal Reserve's decisions to raise or lower interest rates influence investor and consumer expectations and behavior.

monetary policy instruments—tools such as interest rate and money supply, used by the central bank to respond to inflation, real GDP, or other measures of the economy

A central bank's degree of independence rests on the laws of the particular country. In most countries, it remains a separate agency from the government and makes its own decisions regarding the use of monetary policy instruments. This trend toward keeping central banks more independent became apparent in the early 1990s. The rationale behind maintaining a separate central bank is that it helps to prevent the

manipulation of monetary policy for political purposes. Consequently, when the two entities are fairly independent of each other, the central bank and the government may not always agree on the other's methods for maintaining a stable economy.

While the central bank implements monetary policies, the government carries out fiscal policies.

> Two of the fiscal activities of government are spending—on national defense, road building, schools, or transfer payments—and collecting taxes to pay for this spending. When spending is greater than taxes, there is a budget deficit, which must be financed by government borrowing, a third fiscal activity. Policy refers to a plan of action by the government. Hence, fiscal policy is defined as the government's plans for spending, for taxes, and for borrowing to finance the budget deficit, if one exists. (Taylor, 1995: 971)

Monetary and fiscal policy are implemented in order to bring about and maintain economic stability. This often involves the manipulation of certain economic variables that can perhaps best be explained by using the equation for a country's national income (**Y**):

$$Y = C+I+G+X$$

Y represents national income or more generally, GDP (Gross Domestic Product), which is a measure of the value of all the final goods and services newly produced in a country during some period of time. Economists use GDP to measure the production and the income that is generated by a country. A country's productivity and economic prosperity are usually measured and referred to in terms of its GDP. GDP is measured in three ways, but to keep it simple, we will only use the spending approach.

stocks—a financial instrument that is a claim on the earnings and assets of a corporation

bonds—a financial contract that stipulates a specific repayment of the original amount loaned plus interest at a given date in the future

business fixed investment—investment by firms in physical capital, such as factories and equipment

inventory investment—a change in the stock of unsold store goods from one date to another

residential investment—purchases of new houses and apartment buildings

C represents the "consumption" in the economy, which includes purchases of final goods and services by individuals. The government statisticians who collect the relevant data most often define consumption as anything purchased by consumers. The important thing to remember is that this is consumption of *newly* produced final goods and services.

I represents investment, which consists of purchases of final goods by business firms. When economists and investors mention the word "investment," what may cross people's minds are stocks and bonds, investment bankers on Wall Street, and market traders in colorful jackets wildly gesticulating on the floor of the New York Stock Exchange. However, this is only one of the many facets of investment. Investment encompasses more than just purchasing stocks and bonds. It comes in three main forms: business fixed investment, inventory investment, and residential investment.

G represents government (federal, state, and local) purchases of new goods and services. On the news, we hear about government spending for such items as the military, police, education, and infrastructure such as roads and highways. An important thing to note is that G does not

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include the government's payments such as social security, unemployment compensation, and welfare.

exports—the sale of goods abroad

imports—the purchase of goods from abroad

X is for net exports, or exports minus imports. Exports are what a country sells to other countries, and imports are what it purchases from them. When it imports more than it exports, a trade imbalance or deficit results. Just like individuals who go into debt by spending more money than they possess, countries can also go into debt. A country that spends more on imports than it makes from selling exports is in a trade deficit and must borrow from other countries if it further increases its spending on imports. As will be described later, trade imbalances, if severe, can potentially lead to economic instability and financial crises.

Thus, from this equation, **Y = C + I + G + X**, we can see how a country's national income (Y) or Gross Domestic Product can be measured by these four variables: consumption, investment, government spending, and net exports. They all come into play throughout the rest of this lesson.

Interest Rates

Investment hinges on the concepts of interest rates and exchange rates. An interest rate is defined as the amount received per dollar (or any other unit of currency) loaned per year and is often seen in percentage terms. In other words, it is the cost of borrowing that compensates the lender for the declining purchasing power of each unit of currency that is lent out. Due to inflation, a dollar in the future will be worth less than a dollar now. Financial intermediaries such as commercial banks, investment banks, insurance companies, mutual funds, pension funds, and finance companies channel money from savers to investors by accepting deposits and making loans at specific rates of interest. The borrower pays the lender a rate of interest for the privilege of borrowing this money over a certain period of time (similar to a "service charge"). Thus, this process of charging interest is to make more money out of money.

inflation—an increase in price levels

financial intermediaries—firms that channel money from savers to investors by accepting deposits and making loans

open market operations—the buying and selling of bonds in the open market

The central bank controls the supply of money in an economy by using what are called open market operations. By controlling monetary supply and implementing open market operations, it can raise or lower interest rates to influence consumer spending. For example, when central banks, governments, and corporations need capital or money, they can sell bonds to people at a given interest rate. In this situation, the one who sells the bond is the "borrower" and the one who buys the bond is the "lender." The borrower pays the lender a rate of interest over a certain time period that is specified on the bond.

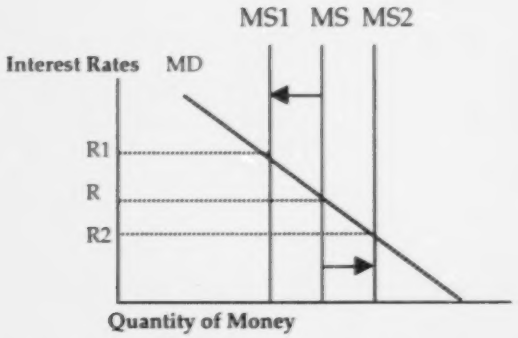
The following principles, and those detailed above, have been greatly simplified for brevity's sake, but for the purposes of this unit, we can think of currencies or money as a product or a good. The Federal Reserve and the central banks of most countries control their interest rates by manipulating the money supply (the monetary reserves in the banking system of the country). If the central bank decides that inflationary pressures are threatening long-term economic stability, it may decide to temporarily increase interest rates as a way to slow down consumer spending, raise consumer saving, and cool off a possibly overheating economy in which people are overinvesting. To increase the interest rate, the central bank sells bonds to the open market in exchange for currency

and then stores that currency in its reserve vaults, thus reducing the money supply in the economy.

If the central bank is convinced that the economy is too sluggish and needs a jumpstart, it may lower interest rates in order to promote investment and encourage consumers to spend more. (Consumer spending is one of the major contributing factors in the growth of the economy.) In this case, the central bank buys back those bonds, thus releasing more money into the economy and increasing the money supply.

The graph for the demand and supply of money (Graph 3) is very much like the graphs that were pictured earlier in this handout. The curve for money demand (MD) is negatively sloped because when interest rates are high, borrowing is expensive, so people demand less of it. When interest rates are low, borrowing is made cheaper and people demand more of it. The main differences between this graph and the ones illustrated earlier are that money supply (MS) curves are vertical and instead of price on the vertical axis, we have interest rates (R). So when the central bank wants to increase interest rates (R1), it reduces the *overall* supply of money by selling bonds to people (MS1). The individuals who buy these bonds give money to the bank in exchange. The bank keeps this money in its reserves. Therefore, the amount of money circulating in the economy is decreased. If the central bank wants to lower the interest rates (R2), it can increase the supply by printing more bills or buying back these bonds (MS2). The bank takes money from its reserves and buys back these bonds from people, thus increasing the amount of money circulating in the economy.

Graph 3:



The Relationship Between Interest Rates and Exchange Rates

An exchange rate can be thought of as the price of one's currency in terms of another country's currency. Let us suppose that we are talking about the exchange rate of the Thai baht to the U.S. dollar. When the Thai baht appreciates relative to the dollar, this means that the baht is relatively "stronger" or more valuable than the dollar. In other words, the baht has more purchasing power than the dollar. Usually, when a country's currency rises against the dollar, this means that with the stronger currency its residents now have the purchasing power to buy more imports than before. With a stronger domestic currency, foreign goods are relatively cheaper.

Conversely, when the Thai baht depreciates relative to the U.S. dollar, the baht is "weaker" and worth less than the dollar. When it depreciates with respect to the dollar, it takes more Thai baht to purchase a dollar than before. This time, the dollar has greater purchasing power. People can buy more if they hold dollars than if they have baht. When a country's currency falls against the dollar, its currency is now relatively weaker and imports are more expensive. The country's own goods are cheaper to foreigners.

Generally, the interest rates and exchange rates within a country influence the level of foreign and domestic investment in that country. If the interest rates within a particular country are high, this means that foreign lenders will get a greater rate of return on the funds that they lend to other investors or firms in that country. The prospect of getting higher returns leads foreign investors to increase their investments in that particular country. For domestic investors, however, higher interest rates may discourage them from investing because it is expensive to borrow in their own currency. If a foreign investor has some tolerance for risk, he might prefer to invest in a country where the interest rates are higher. Where there is more risk, there are higher interest rates and higher rates of return.

Returning to the comparison between the Thai baht and U.S. dollar, if the U.S. interest rate is much lower than Thailand's, this may decrease foreign investment in the United States while increasing foreign investment in Thailand. If a foreign investor holding dollars wishes to invest in Thailand, he will exchange his dollars for baht. Since the higher interest rate in Thailand suggests that the investor will get higher returns on his investment, the demand for the baht increases. This is because foreign investors would rather invest in a country where the currency is of relatively greater value. The increased demand for the baht will push its price up and thus raise the dollar-to-baht exchange rate, which is virtually the dollar price of Thai baht. Foreign investors will choose to invest in Thailand because they will get better rates of return for the funds that they lend out. However, this is only temporary, because if the dollar-to-baht exchange rate gets too high, investors will find that it is getting too expensive to invest in Thailand, or exchange dollars for baht. So they will turn to the United States where it is cheaper to invest in dollars and where the profits will be greater.

profits—the difference between total revenues and total costs

If the opposite occurs, say the U.S. interest rate is much higher than that of Thailand, this is likely to stimulate foreign investment in the United States while dampening the level of foreign investment in Thailand. This may lead to a decreased demand for the baht. In this scenario, outside investors may prefer investing in the United States where they anticipate greater returns on their lendings or investments, from the higher interest rate. A decreased demand for the baht will push its price down and lower the dollar-to-baht exchange rate.

Given the unexpected ups and downs in the currency or exchange markets, countries often adopt a fixed exchange rate regime in an effort to reduce these fluctuations. The term "volatility" is often used to describe the rapid change in prices capable of adversely affecting the economy or creating economic imbalances. If a country's currency is pegged to the

U.S. dollar, this means that its central bank maintains a fixed exchange rate with the dollar. When the United States raises its interest rate, so must the country with the pegged currency. Prior to the 1997–98 Asian financial crisis, most of the developing economies in East Asia had fixed exchange rate systems (in which the central bank buys and sells its own currency to keep the exchange and interest rates fixed at a certain level with the dollar). A fixed system can often create a false sense of security in a currency's stability, and this is one of the many negative factors that plagued East Asia in the latter half of 1997.

QUESTIONS ABOUT ECONOMIC BASICS

Answer the following questions using the information provided in Handout #1, *Economic Basics*.

1. What is the name of the point where the demand and supply curves intersect?
2. What are the characteristics of a perfectly competitive market?
3. What are some things that could shift the demand curve to the right? To the left?
4. What are some things that could shift the supply curve to the right? To the left?
5. Why is the supply curve positively sloped?
6. Why is the demand curve negatively sloped?
7. Give a definition of monetary policy and some examples of how it is used.
8. Give a definition of fiscal policy and some examples of how it is used.
9. Which two entities use macroeconomic tools to control the economy, and which type of policy does each typically use?
10. What does Gross Domestic Product (GDP) measure?
11. Why is GDP often used as a gauge of an economy's strength?
12. Why is it necessary to include X in the Y= C+I+G+X equation?
13. How do central banks control the supply of money in an economy?
14. In countries where governments can control the money supply, how might this governmental control negatively affect the economy?
15. What is the difference between currency and bonds?
16. How can the central bank slow inflation? How can the central bank stimulate investment and consumer spending?
17. What happens to a country's exchange rate when its interest rate increases?
18. Why might a country choose to adopt a fixed exchange rate?
19. Why might a country choose to peg its exchange rate to the U.S. dollar?
20. What does it mean when a currency such as the baht appreciates against the dollar?

ANSWER KEY TO ECONOMIC BASICS

1. Market Equilibrium or Market Price.
2. In a perfectly competitive market, there is free entry and exit of many firms selling similar products; firms take the equilibrium price that is determined by the demand in the market; the total quantity of goods produced is also determined by the market equilibrium.
3. Rightward shift in demand: natural disasters and supplies needed; sudden change in trends that causes many consumers to buy more of a product; anything that increases the overall level of consumption.
   Leftward shift in demand: negative publicity or consumer reports; boycotting of goods; anything that decreases the overall level of consumer demand.
4. Rightward shift in supply means increasing the overall level of supply: improved technology that increases productivity; more firms enter the industry.
   Leftward shift in supply means decreasing the overall level of supply: long-term strikes; natural disaster bringing about shortage of inputs.
5. The higher the price that the firm can get for selling its goods, the more units it will supply.
6. The higher the price of a normal good, the less the consumer will be inclined to buy one more unit of it.
7. Monetary policy: the central bank increases/decreases the money supply to lower/raise interest rates.
8. Fiscal policy: the government makes plans for borrowing, spending, and taxing.
9. Government: Fiscal policy; can try to increase GDP by increasing government spending (defense, education, infrastructure, health care); lowering taxes.
   Central bank: Monetary policy; can increase/decrease consumer spending by lowering/raising interest rates.
10. GDP measures a country's national income or aggregate level of production.
11. The GDP encompasses the important economic variables of consumer spending, investment, government spending, and net exports.
12. Part of a country's income comes from X, its net exports. So to determine how much it gains from trade one takes the difference between the exports that are sold to other countries and the imports that are purchased from those countries.
13. Central banks control the supply of money through open market operations (the selling and buying of bonds) or by printing more currency.
14. For example, a government that controls the central bank may want to stimulate the economy and raise consumer confidence or optimism during an election year by printing more money or lowering interest rates when it might not be economically prudent to do so. This and similar politically motivated actions can be quite detrimental to the economy's long-term stability. It might lead to inflation or recession depending on the existing level of aggregate demand and prevailing price levels.
15. Currency is paper money and coins. A bond is a debt security that promises to make payments periodically for a specified period of time.
16. Raise interest rates; lower interest rates.
17. The exchange rate usually moves with the interest rate.
18. A fixed exchange rate regime may make the currency more stable and predictable in a usually volatile exchange market, but it can be difficult to maintain in the long run.
19. The U.S. dollar is one of the major and stronger currencies in the global market, so countries often peg their currencies to the dollar in order to maintain a degree of stability.
20. The baht's appreciation against the dollar means a rise in the dollar price of baht.

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BACKGROUND OF THE CRISIS

Within the span of a decade, people recognized that East Asia was rising among the ranks of flourishing economies. In the late 1980s and early 1990s, international investors turned their focus eastward because of the amazing rates of growth in the economies of Hong Kong, Taiwan, Singapore, South Korea, Thailand, Malaysia, and Indonesia. With their rapid growth rates, rising living standards, and high rates of private saving, these countries appeared to be promising emerging market economies. In 1993, the World Bank even went so far as to describe these combined economies as "the East Asian Miracle" in its well-known and oft-quoted analytical publication of the same title. So what brought about the sudden crisis in the summer of 1997?

In mapping out the events of the 1997–98 Asian financial crisis, one might preface this segment of the lesson with a description of the economic relationship between Japan and the United States (hereafter, U.S.) in the 1970s and 1980s. For those curious about economic crises in general, it may help to provide some context to what was happening in the two decades before the 1997–98 Asian financial crisis. It is essential to note that the events in Japan in the 1970s and 1980s were very different from those that marked the crisis in East Asia in 1997–98. Among the significant differences were that Japan was the second richest country and a large creditor in the world at that time and was experiencing massive capital outflows. Japan's domestic crisis in the 1980s was characterized by its drastic currency rise. In stark contrast, the East Asian countries that were hit the hardest during the 1997–98 Asian financial crisis were developing economies and experienced large capital inflows from foreign investors. The 1997–98 chaos that pervaded was not purely domestic. Unlike Japan in the 1980s, East Asia experienced a wave of currency collapses rather than currency rises. So with these important differences in mind, one might see how the 1997–98 Asian financial crisis appeared to be so unexpected.

capital outflows—the situation in which domestic investors lend money or invest outside the country or purchase foreign assets

capital inflows—the situation in which a country receives foreign investments in capital

Part A: Japan and the United States—Economic Friction and Domestic Financial Excess[1]

The U.S. faced a growing trade deficit with Japan in the 1970s, which made its relations with its Asian economic counterpart tense and uncertain. Japan had established a thriving powerhouse automobile industry that rivaled those of the U.S. and other industrialized countries in Europe. The activity of domestic investors outpaced Japan's efforts to develop a sound regulatory system to check bank lending and corporate borrowing practices. The U.S. auto industries in the meantime clamored for protection from their Japanese competitors. Thus, the U.S. urged Japan to slacken its exports. However, the trade imbalance between the U.S. and Japan grew steadily worse well into the mid-1980s.

Japanese exports exceeded its imports and the U.S. dollar kept rising against the yen. Consumers in the U.S. were spending more on imported goods (not only from Japan but from other countries to a lesser extent)

[1] Adapted from Hartcher, Peter, (1998). *The Ministry*. Boston, MA: Harvard Business School Press, pp. 60–93; 95–122.

than their foreign counterparts were spending on U.S. products. The appreciation of the dollar made U.S. products more expensive for other countries. The resulting trade imbalance created anxieties about declining profits among U.S. companies. U.S. protectionist trade tariffs threatened to close the doors to international trade. After a meeting was called by the G7 leaders (Plaza Accord in New York, in September 1985), two economic goals for international trade were announced: to push the dollar back down by intervening in the world foreign exchange markets, and to maintain it there by adjusting the macroeconomic policies of those seven countries. All hoped that making the dollar cheaper would lower the prices of U.S. goods, thus enabling consumers in other countries to purchase more U.S. products and thereby raise the level of U.S. exports.

G7 (Group of Seven) — the seven largest world economic powers: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States

By the end of 1985, the first goal was met, and the U.S. dollar fell by nearly 18 percent against the yen. Domestic investment in Japan continued to thrive, and from 1986 to 1990 Japan found itself in the midst of a domestic bubble economy. Its real estate and stock market prices skyrocketed to amazing levels.

bubble economy—a situation in which the prices of assets exceed their fundamental market values

Part B: The Japanese Bubble and the Aftermath

In a bubble economy, investors overanticipate future returns from companies that promise positive growth rates and from increasing real estate values. There is a general expectation that growth rates will continue to climb upward. One might even say that investors get into a frenzy of buying up shares of stock and real estate. Demand soars as other investors join in the buying craze, hoping to acquire assets that will rapidly increase in value over time. Investment capital is made readily available through relaxed monetary policy, featuring low interest rates. Property developers who are anticipating huge profits from this optimistic market artificially raise the values of real estate. Only in a bubble market would one find people willing to pay such exorbitant prices for property, because they know that they can sell it at an even higher price. This causes a trend in which investors' optimistic expectations of future growth rates often exceed the actual rates of return for these "wonder" companies and stocks. Investors contribute to the expanding bubble, and prices continue to climb upward until fears of overvaluation set in. Realizing that expectations have exceeded actual values in the stock and property markets, investors pull their money out, prices take a drastic plunge, and the bubble finally bursts.

stock—a financial instrument that is a claim on the earnings and assets of a corporation

As Japan attempted to maintain its new exchange rate at a higher level, the U.S. dollar became cheaper and the yen appreciated further. Japan's exports started to weaken in the late 1980s. Its higher exchange rate made its products more expensive relative to those produced in other countries. In the meantime, Japan's Ministry of Finance lowered its interest rates. The general theory is that these extremely low interest rates caused Japan's bubble economy in the period between 1986 and 1990. In fact, from 1987 to 1989, interest rates fell to 2.5 percent. Lower interest rates led to increased borrowing. What followed was a period of over-exuberant investing.

speculative—buying or selling assets in expectation of profiting from market fluctuations

Banks failed to assess the risks associated with highly speculative accounts and to restrict lending practices. Large corporations raised money on the stock market and then placed it in banks where it earned

additional interest. Since money could be made so easily in the stock and real estate markets, banks soon found themselves with fewer customers who needed to borrow. So banks, too, joined in the investment frenzy and lent out vast sums of money to real estate developers without protecting themselves against default risk. Because investor confidence was so high, many also neglected to ensure that their investments were diversified enough to compensate for any downturns in the market. The bubble became even bigger in the late 1980s as the banks contributed to the high prices of land and stocks in Japan.

default risk—the chance that the borrower will be unable to make interest payments or pay off the original amount borrowed

diversified—holding a balanced variety of assets from different industries in order to spread out or minimize the risk of possible losses

Bank of Japan—Japan's central bank

Japan's bubble economy expanded further until the Bank of Japan and the Ministry of Finance decided that the market was indeed overvalued. The Bank of Japan began to raise interest rates in May 1989. Japan's efforts to deflate its bubble soon led to an interest rate hike to 6 percent in the same year, which put a sudden halt to the frenzy of investment. Hence, the bubble popped in 1990 and Japan's stock markets crashed. The stock prices were 63 percent below 1989 values. Many banks and other financial intermediaries could not pay their depositors and several real estate companies became insolvent as well.

insolvent—a situation in which a firm or bank has gone bankrupt

recession—a decline in real GDP (GDP adjusted for inflation); a period of reduced economic activity

After the Japanese stock market collapsed, the country fell into a recession that lasted through the 1990s. Hundreds of billions of dollars in debt were the result of frenzied cheap borrowing. Despite the central bank's efforts to stimulate the economy by decreasing interest rates, the recession deepened. The main question was how to end the recession and energize the economy when interest rates were already so low. People were saving instead of spending, and so the Japanese economy contracted. In 1993, the Japanese government began to implement major stimulus packages and ease its taxes in order to pull the economy out of its recession. Japan's once-envied period of financial exuberance was subsiding on a dour note.

stimulus packages—sets of policies intended to increase economic activity

Part C: Emerging Dominant Entities in East Asia[2]

During its stint as the second richest player in the world economy in the 1970s and 80s, Japan's exchange rates soared and led to immense capital outflows to its Asian neighbors. Japanese companies relocated to cheaper countries. As Japan suffered through a recession after its domestic bubble had burst, its southern neighbors stepped into the limelight, boasting of their robust economies and impressive rates of growth. Countries in East Asia experienced average annual growth rates of roughly 8 percent, which was several times greater than those of other industrialized countries combined, including the U.S. In an effort to stabilize their currencies and to protect their exchange rates from wild fluctuations, most of the countries in East Asia pegged their currencies to the U.S. dollar, perceived to be the strongest currency in the global economy.

pegged (exchange rate)—the system in which a country fixes its exchange rate in relation to an independent and presumably more stable currency

The initial apparent economic successes of Thailand, Indonesia, Malaysia, and South Korea stemmed from a variety of factors. In these economies, cheap unskilled labor was employed in industries specializing in manufactured goods. Since factories could employ cheap labor to make products such as toys, clothing, and electronic goods, the firms could

[2] Adapted from "Frozen Miracle," *The Economist*, March 7, 1998, pp. 3–18.

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capital—the factories, improvements to land, machinery and other tools, equipment, and structures used to produce goods and services

charge lower prices for these products. The cost of capital used to produce these goods was also low, but artificially so because of government subsidies, enthusiastic foreign lending, and cheap dollars due to managed exchange rates. With regard to "cheap dollars," these countries were setting their currencies to be artificially undervalued so as to make their goods appear cheap to foreign buyers.

current-account surpluses—revenues made from selling exports exceed the expenditures on imports

For a time, the East Asian countries were accumulating current-account surpluses. Countries in the West purchased manufactured goods produced in East Asia. Thus, domestic spending was low and exports were in good shape. By the mid-1990s, international investors noticed the potential for further growth and future profits in these developing countries, and so they poured money into East Asian industries, stock markets, and real estate.

The small developing countries in East Asia appeared to be thriving with open trade and economic activity long before the summer of 1997. Other countries marveled at these developing countries' high savings rates and feverish rates of investment. Investors believed that the economies of Thailand, Indonesia, and Malaysia would soon resemble the original "tiger economies" of Hong Kong, Singapore, Taiwan, and South Korea. Investors and international economists alike anticipated further potential for growth in the East Asian economies.

Many global investors were so convinced that their investments in East Asia would pay off in the long run that they failed to look beneath the surface of the climbing stock prices and real estate values. So many years of unmitigated success inevitably encouraged complacency, so that governments were slow to act when the first signs of trouble emerged. Such growth rates seemed to bode promising results. Ostensibly, the "tiger cubs"— Malaysia, Indonesia, and Thailand—were experiencing genuine economic expansion and their governments appeared to be implementing sound fiscal policies. But that was only on the surface. The buzz of investor activity in this region somehow obscured the underlying structural problems that would eventually hamper their economic success.

macroeconomic—relating to the branch of economics that examines the workings and problems of the economy as a whole (economic growth, inflation, unemployment, and economic fluctuations)

deregulate—to privatize, or sell government-owned companies and financial institutions to private investors

Part D: Another Bubble Economy and Weak Macroeconomic Fundamentals

The underlying structural weaknesses in the financial sector that had perhaps been all too conveniently ignored in the late 1980s and early 1990s, surfaced to haunt Asia in the summer of 1997. Many economists point to the blind intensity of foreign lending as a major cause of the 1997–98 Asian financial crisis. In the mid-1990s, East Asian countries had been urged to deregulate their financial markets in order to stimulate international trade and facilitate other financial transactions. Deregulating their capital markets meant making sure that their governments were not majority owners and controllers of firms and financial institutions. This would allow foreigners to purchase their assets more easily.

Much of this pressure to free up their capital markets came from the United States Treasury, various finance ministries in Europe, and the international markets. Prior to the 1990s, East Asia had never

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experienced such a rapid influx of foreign investment. The liberalization of their financial systems came so quickly that the governments did not have time to establish sound regulatory policies and supervisory institutions that would properly assess credit histories and default risks. Countries such as Thailand, Malaysia, Indonesia, and South Korea quickly began accumulating horrendous short-term debts that initially went by unheeded. Meanwhile, foreign investors were expecting the companies in these developing countries to grow rapidly and bring in profits that would more than make up for their initial costs of investment.

short-term debts—loans and other obligations that must be repaid within one year

While predictions of future growth rates were overly optimistic, capital was inexpensive and borrowing was made easy. Thus, more feverish borrowing ensued. Resources were invested in property, the currency market, and the industrial sector. Investors poured money into real estate and drove up property values far higher than they were really worth. Money was invested in underperforming companies. Investors would not realize until it was too late that their finances were allocated inefficiently to dead-end sectors and capital-saturated industries. In other words, these were nonperforming loans in empty new business buildings, unused machinery, and other sectors that failed to churn out returns on investment. Domestic firms had come to rely too heavily upon short-term foreign loans of which the benefits proved dubious. Short-term loans had been the easy solution for domestic borrowers especially in Thailand, because they could pay off old debts with newly borrowed money.

dead-end sectors—areas in the market that fail to produce returns on investment; money-losing business projects

capital-saturated industries—industries or particular sectors of the economy characterized by excessive investment

So one might ask, why did investors place their money into dead-end sectors in the first place? Part of the cause has been attributed to the non-transparent accounting practices that occurred among banks, corporations, and governments. In this case, accounting methods were described as being non-transparent or opaque because money-lending went through circuitous paths, and sometimes large transactions were kept suspiciously off the balance sheets. This lack of corporate and banking discipline allowed more and more loans to go by unchecked. Due to these non-transparent accounting practices, foreign lenders were unable to properly evaluate the riskiness of business projects and developing companies before committing their money. A number of corrupt businesses, including some *chaebols* in South Korea, kept opaque accounting records that hid shady dealings with the government and banks.

chaebols—a Korean term for corporate conglom-erates in which a main firm owns numerous diversified subsidiaries

Moral hazards combined with inadequate regulatory and supervisory institutions only made such negligent accounting methods worse. Moral hazard occurs when the provision of insurance against risk encourages behavior that makes the risk more likely to occur. For instance, if a driver is insured for all possible accidents, he may tend to engage in riskier behavior and drive more carelessly, since he knows that he will not be fully responsible for the costs incurred by his actions. Because of the underlying assumption that the government would always be there to bail out troubled firms and banks, businesses continued to borrow excessively, ignored the associated risks, and wasted foreign resources. Banks kept on lending at remarkably low rates and foreign investors contributed their funds. This became a self-perpetuating cycle of moral hazard and financial irresponsibility. Like the insured driver, many of

the developing East Asian countries borrowed excessively because they knew that the governments would bail them out in times of trouble.

portfolio—investment in a collection of assets

Shoddy bank regulation in Indonesia, Malaysia, the Philippines, South Korea, and Thailand led to easy lending that worsened the already deteriorating quality of the banks' portfolios. For the most part, banks had not checked corporate borrowers for secure collateral. Important business transactions were largely based on personal ties and family connections rather than diligent assessment of credit histories and default risks.

collateral—property that is promised to the lender to guarantee payment in the event that the borrower is unable to make debt payments

crony capitalism—the practice of money-lending, contract-granting, and licensing based on close personal ties, rather than on assessment of credit history

This brings up another economic weakness that plagued some of the East Asian countries: crony capitalism among members of governments, banks, and firms. Amid the excess of foreign lending, banks in some areas of East Asia were often issuing loans to favored corporations under the direction of the governments. In contrast to the stronger economies of Hong Kong, Singapore, and Taiwan, which had fairly clean and well-regulated banking and corporate sectors, the financial sector in Indonesia was rife with crony capitalism, and to a lesser extent so were those of Thailand, Malaysia, and the Philippines. During the boom, institutions responsible for supervising the financial sector and developing regulatory policies failed to keep up with the growing demands of investors.

Part E: Unsecured Debt and the Resulting Currency Crisis

balance of payments—a bookkeeping system for recording all the financial transactions between countries

In the mid- to late 1990s, foreign debt soared as did the current-account deficits in Thailand, Indonesia, Malaysia, and South Korea. According to the International Monetary Fund (IMF), short-term foreign loans to Thailand amounted to 7–10 percent of GDP in each of the years 1994–96. "Thailand's total debt—public and private—rose from 38.3 percent of GDP in 1990 to 50.9 percent of GDP six years later" (Chanda, 1998: 10). Thailand and its neighbors were laden with so much debt to foreign investors that foreign-exchange reserves were quickly being depleted. They were soon facing balance of payments problems in which they could not pay off their debts to foreign lenders. To make matters worse, East Asian interest rates rose still further with U.S. interest rates as the Federal Reserve tried to curb inflation in the United States.

Prior to the wave of currency crashes in the summer of 1997, foreign investors had assumed that Asian currencies such as the Thai baht were fairly stable because they were pegged to the U.S. dollar. The peg gave them a false sense of security about their investments. Even domestic investors hoped to cash in on the future profits offered by the markets, to the extent that they neglected to diversify their assets (or to invest in different industries in order to minimize losses). Some investors questioned the sustainability of the peg and the long-run profitability of their investments in Asia as well as other emerging markets in Russia and Latin America. They had second thoughts about the ability of capital-borrowing companies to pay off their short-term debts.

More people began to suspect that property values and stock market prices were extremely inflated, and investor confidence started to waver as the bubble expanded further. Sluggish export growth and empty office buildings fed worries of an overvalued market. Precious money had been squandered on foolhardy projects. The economies of Indonesia,

Malaysia, the Philippines, and Thailand would soon have to pay for such inefficient allocation of resources.

Financial problems were often exacerbated by deeply rooted corruption in some of the East Asian governments, namely, Indonesia. The mix of political instability and fiscal irresponsibility compelled many once-enthusiastic foreign lenders to worry about their investments in Asia. Hence, there was a general flight to quality, which meant that foreign investors began withdrawing their money from the stock, real estate, and other speculative markets in East Asia when they realized their exposure to such high risks in these developing markets. Rising interest rates were often followed by high rates of loan defaults. More investors who realized that the firms in these developing countries would be unable to pay off their accumulating debts, became reluctant to lend money. As a result, many East Asian corporations found themselves drowning in short-term foreign debt.

This atmosphere of panic reduced the demand for Asian currencies and placed a severe downward pressure on currencies and stock market prices. Severe problems ensued as a result of the exchange rate volatility. Even as Asian currencies fell, producers became less competitive, exports sank, and current-account deficits widened. The central banks had to sell off foreign reserves in an effort to prop up exchange values, but this was a losing battle. Asian currencies continued their free fall. The debts in borrowed dollars were getting harder to pay off with domestic currency that was declining in value. What followed was a cycle of currency collapses throughout the region. When companies could not pay back their loans to banks and foreign lenders, a cycle of bank busts, corporate bankruptcies, and further currency depreciations throughout East Asia commenced.

bank bust—a situation in which a bank goes out of business because it cannot pay its depositors and other creditors

currency depreciation—a decrease in a currency's value

Past economic events returned to haunt Asia. Stretching back to the late 1980s and early 1990s, the fluctuations in the dollar-to-yen exchange rate had given rise to problems, as seen in Japan's case. Exports in Asia were sluggish as the dollar appreciated against the yen and caused a ripple of devaluation anxieties in the East Asian economies. A few economists claim that China's currency devaluation in January of 1994 may have been partly to blame for undermining the competitiveness of the rest of the East Asian economies. This goal to lower the value of the Chinese yuan, in effect to make its goods cheaper in the Asian market and further raise its current-account surplus, may have tipped the scales toward regional currency instability that eventually led to the 1997 currency meltdown in East Asia.

currency devaluation—the resetting a currency at a lower fixed value

The Thai baht was the first to crash. Weak currencies such as the Thai baht became the target of aggressive currency speculators who counted on their failure. A speculator borrows a vast sum of a weakening currency that he believes will soon crash in value. Betting on the assumption that the currency price will fall sometime in the near future, the speculator immediately sells this vast sum of borrowed currency before it falls. By contributing to this surplus of currency which exceeds demand, the speculator helps to cause the currency's price to plunge (that is, if the borrowed amount is significant enough in the first place). If the value does fall, he buys back the amount of currency that was initially

speculator—one who bets on the fluctuations in the market in order to make a profit

borrowed, at the new and much lower price. Then the speculator returns this borrowed sum after having made a profit by selling high and buying low. In other words, the speculator makes a profit when the currency crashes because he first borrows an amount, immediately sells it, buys an equal sum at a lower price, and then finally returns the initial borrowings.

liquidity crisis—a situation in which firms and individuals cannot convert their assets into cash or find the money to repay their debts

float—to allow the exchange rate to be determined by the market

Initially, the Thai government was determined to stick to the pegged currency regime. It attempted to fight off speculators and keep the Thai interest and exchange rates high by selling its foreign exchange reserves and storing the baht in its vaults in order to contract the money supply. This led to a credit shortage and liquidity crisis in which firms and individuals could not find the money to repay their massive debts. The Thai government resisted devaluation until it realized that its foreign exchange reserves were rapidly being depleted and that it could no longer fend off the attack by currency speculators. The central bank's intervention was short-lived. Thailand's government finally allowed the baht to float in July of 1997.

Similarly, in Malaysia, Indonesia, South Korea, and the Philippines, investors panicked and pulled out of the asset markets in a frenzy of selling to recover their money. Prices of the various asset markets—real estate, stock, and currency exchange—plummeted. Households and firms were unable to pay off their debts. As in Thailand, banks that had lent funds to corporations with dubious credit records went bust. Once the banks and other financial intermediaries went bust, those very businesses and others that immediately needed money also became insolvent. Investment shrank further, and this worsened the problems of rising inflation and ever-climbing interest rates that threw the rest of the East Asian economies, strong and weak, into chaos throughout the remainder of 1997 and the early half of 1998.

Part F: Ignoring the Winds of Caution?

In the months prior to the financial crisis, some international economists suspected that this breakneck growth in investment was too good to be true. However, most of the public did not realize until it was too late that the developing East Asian countries were operating in an environment of non-transparent or opaque corporate accounting, shoddy bank regulation, rampant crony capitalism, ineffective bankruptcy laws, and excessive short-term capital inflows—in short, a gigantic region-wide bubble economy. The exact causes of the 1997–98 Asian financial crisis are still being debated. But among the countless theories proposed by economists, there are two schools of thought that are worth mentioning.

On one front, economists posit that the East Asian countries that suffered most during the 1997–98 crisis started off with such weak macroeconomic fundamentals that trouble was just waiting to happen. These countries had been warned of their precarious economic situations and inefficiencies, but in the midst of the boom, the precautions were largely dismissed with a complacent shrug. Weak firms had not been allowed to fail and exit the market, which left little space for small but potentially thriving firms to establish themselves. Central banks were holding insufficient reserves of foreign exchange currencies. The legal systems and the banks' regulatory/supervisory policies were inadequate and lax. Governments in Indonesia, Malaysia, and Thailand were highly

bureaucratic and often corrupt. Dubious connections among governments, banks, and corporations short-circuited market efficiency. Moral hazards went by unchecked, due to inadequate safeguards in the economy. Inefficient currency exchange arrangements put strains on the weakening economy. According to this current of thought, the countries themselves were largely to blame for their problems (Lederman, et al., 1998: 6). When investor panic closed in, chaos resulted.

financial globalization—the dramatic increase in free capital flows across the world; international investors lend money to or invest in companies in many different countries

On another front, there are economists such as Professor Paul Krugman, of the Massachusetts Institute of Technology, who suggest that while there were ostensible problems in these countries (especially in Indonesia and to some extent in Thailand and Malaysia as well), the main cause for the crisis in East Asia was financial globalization. This term is used to describe the dramatic increase in free capital flows across the world and Asia in the 1990s. Economists like Krugman believe that the crisis could not be solely attributed to the weak macroeconomics of developing countries such as Thailand, Indonesia, Malaysia, South Korea, and the Philippines. After all, the crisis did spread to Hong Kong, Taiwan, and Singapore, which had sound economic fundamentals but had failed to escape the domino effects of the diving stock, real estate, and currency markets.

The contagion-like manner of the financial crisis has led some to believe that the entire global financial system was largely to blame, and that what happened in 1997–98 was actually an "emerging market crisis," rather than an exclusively "Asian" crisis. This is because developing economies as far away as Eastern Europe, Russia, Latin America, and Africa also experienced the negative shocks. Krugman and his colleagues state in retrospect, that the economic downturn in East Asia was inevitable, given some of the problems that are inherent in most emerging markets: markets were growing ever more interconnected with the increased intensity and complexity of capital flows; governments were stubbornly sticking to fixed exchange rates; and stronger economies were being affected when weaker neighbors imprudently deregulated their financial markets without first strengthening the regulatory infrastructures.

Yet even with all this taken into account, the crash in the East Asian financial markets caught many off guard. Hong Kong, Taiwan, and Singapore were not completely immune to the waves of investor panic and resulting stock market crashes and recessions. These three "tigers" experienced the negative economic shocks even when their governments appeared fairly non-corrupt, economies exhibited strong fundamentals, and central banks practiced sound monetary policies.

Their economic imbalances and currency fluctuations stemmed from their trade connections with the rest of East Asia. However, since Hong Kong, Singapore, and Taiwan had the added advantage of holding abundant foreign exchange reserves, they were better equipped to fight off greedy speculators who anticipated the crashing of their currencies.

After a period of prosperity, East Asia took a painful and humbling blow in the latter half of 1997 and throughout 1998. Everyone was forced to reevaluate the importance of macroeconomic fundamentals and the implications of financial globalization. In some ways, it took a wave of

market crashes, currency devaluations, credit squeezes, and resulting recessions to make the "tiger cub" economies and their other emerging counterparts realize the urgent necessity of economic structural reform and financial discipline. They provided a telling example of the precariousness of emerging markets. All had witnessed the potentially lethal combination of hasty financial liberalization, weak banking supervision, and rigid currency regimes. As these ailing "tiger cub" economies struggled with currency meltdowns, they turned to the International Monetary Fund for help. The IMF assisted some of these countries in reorganizing their financial sectors and finding a path toward economic recovery. How the IMF provides financial assistance and advice on implementing reform is the subject of Lesson Two.

Group Task

Create a newspaper page reporting on the processes highlighted in your assigned part of Handout #3 (Parts A–F). This page must consist of an article 300–500 words in length and an appropriate headline. You must also include one of the following:

- a photograph with a caption
- a comic strip
- an editorial or opinion piece
- a graph representing one of the processes detailed in your segment
- a political cartoon
- a personal narrative (a story written from the perspective of someone affected by the crisis)

HELPFUL WEBSITES

AccessAsia
http://www.accessasia.org/links/news/index.asp

Asia Point Network: Asian Economic Crisis
http://www.asiapoint.net/insight/asia/regional/crisis/economy.htm

Asian Economies Report
http://www.washingtonpost.com/wp-srv/business/longterm/asiaecon/keystories.htm

The Asian Crisis Home Page
http://faculty.washington.edu/karyiu/Asia/

The Asian Economic Crisis: Points of View
http://russia.shaps.hawaii.edu/economic/asian-crisis.html

BBC News Online: Special Report
http://news.bbc.co.uk/low/english/special_report/1998/asian_economic_crises/newsid_45000/45468.stm

Economic and Financial Turmoil in South-East Asia: Origins and Consequences
http://www.aph.gov.au/library/pubs/cib/1997–98/98cib08.htm

IMF Home Page
http://www.imf.org
http://www.imf.org//np/speeches/1998/061998.HTM

Issues and Controversies: Asia's Economic Crisis
http://www.facts.com/icof/i00063.htm

Megastories: Asia's Economic Crisis
http://www.megastories.com/seasia/

Policy.com: IMF Funding February 2, 1998
http://www.policy.com/issuewk/98/0202/020298d.html

Robert Garran's East Asia Web Site
http://www2.dynamite.com.au/garran/index.htm

U.S. Department of State International Information Programs
http://www.usinfo.state.gov/regional/ea/asiafin/homepage.htm

Welcome-to-China.com: Asia's Economic and Financial Crisis 1997–98
http://www.welcome-to-china.com/crash97/index.htm

What Caused Asia's Economic and Currency Crisis and Its Global Contagion?
http://www.stern.nyu.edu/~nroubini/asia/AsiaHomepage.html

Lesson Two

THE INTERNATIONAL MONETARY FUND (IMF)

Organizing Questions

- What are the goals of the International Monetary Fund (IMF)?
- How is the IMF structured?
- How does the IMF help countries in financial trouble?

Introduction

In this lesson, students will learn about the origins of the IMF and its primary aims. They will examine its history and organization in order to develop a clearer understanding of how the IMF assists member countries that are facing serious economic problems. In the Team Quiz activity, students will be divided into groups and challenged on their understanding of the IMF. In the second activity, students will design brochures that emphasize the key attributes of the IMF. This is meant to encourage students to apply their creativity and express what they have learned about the institution. With a knowledge of how the IMF works, students will be able to discuss in class or on their own, its recent actions and whether or not it has been effective in helping the economies of different countries.

Objectives

knowledge

- to learn why, when, and how the IMF originated
- to understand its initial goals and how they have evolved over time
- to articulate how the IMF functions on a daily basis

attitude

- to appreciate the significance of the IMF in the global economy
- to comprehend the challenges that the IMF and countries face when dealing with economic reforms

skill

- to articulate the main differences between the IMF and the World Bank
- to identify which countries the IMF has helped in the past

Materials

- Handout #1, *The International Monetary Fund*
- Teacher Information Sheet, *Answer Key*
- Question Card Set #1, *Easy Questions (10 Cards)*
- Question Card Set #2, *Medium Questions (10 Cards)*
- Question Card Set #3, *Difficult Questions (10 Cards)*
- Help Cards
- Handout #2, *Score Sheet*

lesson two

- Handout #3, *Team Quiz Rules*
- Activity Card, *IMF Brochure Instructions*
- Stopwatch
- An assortment of colored and white 8.5" x 11" paper
- Colored markers, pens, pencils
- Scissors, glue, tape

Time

2 class periods, 1 night of homework

Teacher Preparation

1. If you have not already done so as per the instructions in Lesson One, make 1 copy per student of Handout #1 and distribute this for homework reading before starting Lesson Two.
2. Make transparencies out of Question Card Sets #1–3 and cut into individual question cards. The question cards are not numbered or labeled, so be sure to keep the easy, medium, and difficult questions separate.
3. Make 1 copy of Handout #2.
4. Make 4 copies of Handout #3.
5. Make a transparency out of Handout #3 if you feel this is necessary. (See Procedure Step 3.)
6. Make 4 complete sets of answer cards A–D by writing the letters "A", "B", "C", and "D" on separate sheets of 8.5" x 11" paper. You can laminate these for future use.
7. Make 4 sets of Help Cards.

Procedure

1. In this lesson, students will attain a basic knowledge of the history of the IMF as well as its purpose and structure. Later in Lesson Three, they will be asked to draw upon their understanding of these readings to find out more about the IMF's past involvement in Asia.

2. Before beginning this lesson, students should already have read Handout #1 for homework. Inform students that they will be participating in a Team Quiz activity to demonstrate their knowledge about the IMF. The quiz is loosely modeled after the television game show "Who Wants to Be a Millionaire?"

3. Divide the class into 4 groups to form the teams. Distribute 1 copy of Handout #3, *Team Quiz Rules*, to each team, and keep a copy available for your own reference. Review these rules to make sure students understand how the game works. If you think it would be helpful, make a transparency of the rules to review as a class.

4. Assign one student to be the timekeeper, who will use the stopwatch to enforce the 30-second time limit. The same student can be the scorekeeper, using the Score Sheet provided in Handout #2.

5. Position the 4 contestants in front of the classroom sitting at desks and distribute 1 set of answer cards A–D and 1 set of Help Cards to each contestant. During the game, the students can look at the overhead transparency as the questions are being asked.

6. The game is finished when all questions have been answered. Tally up the points to see which team wins.

7. At the next class period, divide the class into small groups of 3–4 students. Distribute 1 copy of Activity Card, *IMF Brochure Instructions,* to each group. Allow 1 class period for each group to design an 8.5"x 11" tri-fold informational brochure about the IMF. These may be collected and/or judged. The brochures should be creative and succinct but cogent, attractive, and accurate.

8. Summarize this activity by reviewing the following key points about the IMF:
   - The IMF was created out of concern for international monetary cooperation and global economic harmony.
   - The IMF seeks to promote the smooth exchange of foreign currencies to facilitate trade among countries.
   - The IMF has three primary functions: (1) regulatory; (2) policy advisory; (3) financial
   - The IMF gets the greatest share of its funds from member countries.
   - The IMF focuses more on macroeconomic issues like exchange rate stabilization and adjustment, whereas the World Bank deals with countries on a more microeconomic level, especially with regard to poorer countries.

9. Inform students that these key points about the IMF will be important to keep in mind for the activity in Lesson Three.

handout #1

THE INTERNATIONAL MONETARY FUND*

History of the IMF

The Great Depression of the 1930s marked a period of worldwide economic downturn and financial instability. Currency values spiraled downward and international trade contracted significantly. The economic instability, drastic price fluctuations, and high levels of unemployment in the United States and Europe made it clear that some kind of international body was necessary for bringing about international monetary cooperation and global economic harmony. Many international meetings took place during this time; however, most failed to address the key economic issues. It was not until the early 1940s that two economists, John Maynard Keynes and Harry Dexter White, proposed that a permanent international organization be established to promote free currency conversion and transparent or consistent values for currencies.

In the midst of World War II, 44 nations sent representatives to Bretton Woods, New Hampshire to negotiate the plans for the establishment of the International Monetary Fund (IMF). In December of 1945, the representatives signed the Articles of Agreement. According to the IMF's Articles of Agreement, "surveillance" is one of the core objectives of the IMF, and includes "the expansion and balanced growth of international trade in a setting of stable and orderly exchange arrangements within a multilateral system of payments free of exchange restrictions." In 1947, it established the Bretton Woods par value system in which exchange rates were fixed against the dollar and at an unchanging dollar price of gold. This system, also known as the gold exchange standard, held the dollar as the principal reserve currency.

Up until the 1960s and 70s, the par value system successfully kept currencies relatively stable and predictable. However, during the global economic recession of the 1960s and 70s, U.S. gold reserves became increasingly inadequate to meet the growing demand for gold in exchange for dollars. The par value system was replaced by a system of floating exchange rates, as detailed in the second amendment to the Articles of Agreement, adopted in April of 1978. This new system allowed member countries to adopt the exchange arrangements of their choice. The value of foreign currencies was no longer tied to the price of gold, and individual countries could then focus on domestic goals in their monetary policies.

floating exchange rates—an arrangement that allows the marketplace to determine the price of foreign money

Purpose of the IMF

The IMF is an organization with diverse but limited capacities. Since its inception in the 1945, the IMF has modified its goals in response to outside criticism of its agenda. People seem to take for granted the existence of the IMF and view it as yet another bureaucratic institution that dictates international economic policy. Especially after the financial crises in Russia, Latin America and Asia, its legitimacy and effectiveness as an international cooperative forum has been questioned by academics,

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* Adapted from Driscoll, David D., (1998). "What is the International Monetary Fund?" IMF Homepage *http://www.imf.org/external/pubs/ft/exrp/what.htm.*

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politicians, and others. But as this lesson will explain, the IMF has a unique character and an important set of responsibilities.

The IMF seeks to promote the smooth exchange of foreign currencies to facilitate trade among countries. This is with the hope that if countries limit restrictive trade barriers or tariffs, trade balances will follow, which will bring about global benefits. Ideally, in a setting of stable exchange values, minimal trade imbalances, and unimpeded access to international markets, income or revenues will increase the countries' GDPs (Gross Domestic Product), stimulate their economies, increase jobs and investment for economic growth, and expand their production capabilities.

As an institution of surveillance, the IMF has functions that can be organized into three categories: 1)regulatory; 2) policy advisory; and 3) financial.

1. Regulatory Function: How does the IMF maintain global economic stability?
A collective desire for global economic stability and prosperity is one of the main motivations behind the IMF's decision-making processes. The IMF was primarily established as a forum for volunteering countries to consult with one another in an effort to maintain a stable system of buying and selling their currencies so that international trade and foreign exchange of money could occur among countries promptly and seamlessly. The institution tries to be flexible yet disciplined as it pursues its goals to benefit all member countries involved.

The IMF's regulatory function is essentially to oversee each member country's adherence to established exchange arrangements and the guidelines in the Articles of Agreement, which is implicit upon their joining the institution. A degree of candor is also expected of the members since the IMF's effectiveness hinges on the information that it gets from them. Therefore, it becomes necessary for each member country to update the others on its recent domestic economic policies, present economic status, and arrangements for determining the value of its currency with respect to those of the other member countries.

In order to evaluate a country's justifications for departing from the normal rules, the IMF has to keep abreast of the different domestic economic policies that are being implemented. Therefore, the regulatory function of the IMF serves to justify its policy advisory function.

2. Policy Advisory Function: How does the IMF operate?
As previously stated, the IMF's policy advisory function ties in closely with its regulatory role. When a country finds that it must deviate from the standard rules set forth in the Articles, the IMF evaluates whether the country's transitional measures are necessary and practical for the short-term. The IMF approves or discourages plans that might include imposing exchange restrictions or discriminatory trade practices in order to restore current-account balances. Occasionally, it may even use what is called moral suasion to pressure and persuade them to implement certain economic reforms and observe the IMF code of conduct. Other methods of pressuring an offending member to fulfill its obligations (i.e., repaying

current-account balance—a measure of a country's net exports of goods and services

moral suasion—In the case of the IMF, it is the IMF's application of pressure rather than force to get its members to adhere to a policy

loans from the IMF or keeping the other member countries informed of its exchange arrangements) include the following: withholding IMF support, declaring a member ineligible for loans, or in rare but serious cases, asking it to resign its membership in the IMF.

The IMF must examine the soundness of a member's intended policies, whether those economic plans will reasonably improve its economic status, and whether the member is complying with the exchange arrangements. In its advisory role, the IMF regularly consults with member countries and provides technical assistance in the following ways:

1. It helps members design and implement fiscal and monetary policies.
2. It helps members develop their central banks and treasuries.
3. It maintains and deals with the members' financial transactions with the IMF.
4. It collects and processes economic statistical data.
5. It trains officials at the IMF and at other international financial organizations.

autocratically—with undisputed power

Contrary to what most people think, the IMF does not dictate policy autocratically. The representatives of the member countries are virtually the ones who hold the power when it comes to determining the countries' policies and the reform packages. Like a global senate, the representatives from the governments of the member countries ultimately make the important decisions and formulate the lending arrangements to countries in economic difficulty. Policy is largely made through a majority-rules process in which the IMF serves an intermediary role as a forum.

The Process of an IMF Consultation

As a cooperative forum, the IMF conducts periodic consultations at least once a year in order to assess a country's exchange policies and its economic condition. These periodic consultations proceed in three phases:

Phase 1: An IMF team travels to a country's capital to gather statistical data (net exports, wages, prices, employment figures, interest rates, tax revenues, government spending, etc.).

Phase 2: The IMF meets with high-ranking government officials to ask questions and evaluate the effectiveness of recent reform policies, exchange rate arrangements, and possible policy changes for the next year.

Phase 3: The team returns to headquarters to prepare detailed reports. It debriefs the Executive Board and Board of Directors. They discuss more specific economic issues and offer suggestions on policy improvements. If a member is experiencing serious economic troubles, additional meetings may be held. This is especially important if the IMF membership believes that a country is acting irresponsibly and endangering the economic well-being of other member countries. The team's conclusions are published in the IMF's biannual *World Economic Outlook*.

balance of payments problem—a situation in which a country has failed to take in enough foreign money (gained from exports) to pay for what it imports from other countries

3. Financial Function: How does the IMF offer financial assistance? The IMF's third function is to provide temporary financial assistance to member countries experiencing dire balance of payments problems. If the IMF helps a distressed member country to pay off its debts to other countries, it may be able to prevent the country from implementing drastic domestic economic policies that may harm itself and other countries in the long term. By reducing the scale and duration of these financial imbalances, the IMF tries to avoid a domino effect of economic troubles that might ensue in neighboring countries.

Money inflows come from the revenues made by a country's exports, its banking and other financial services, tourism, overseas investment and sometimes foreign aid, if the country is a poor one. Countries experiencing severe current-account deficits (imports exceeding exports) often undergo currency depreciations which in turn erode purchasing power. If the depreciation is dramatic enough, the country may face a balance of payments problem, in which case it asks the IMF for assistance.

In such cases, member countries can appeal to the IMF for loans called Special Drawing Rights (SDRs). When a country becomes a member of the IMF, it contributes a quota subscription (in gold or a convertible currency), determined by a member's wealth and economic performance. The amount is periodically updated to reflect any changes in economic status. The quota subscriptions form a pool of funds from which the IMF can disburse to members facing economic crises.

All member countries contribute different quota subscription amounts, which correlate directly to their voting power and how much they can borrow from the IMF or receive in the form of SDRs. The greater the quota subscription, the greater the say the country has over IMF lending arrangements and policies. According to 1998 figures, the United States has the greatest voting power with 18 percent of the votes and a quota subscription of about $35 billion. This is a striking contrast to Palau which has 0.002 percent of the votes and a quota of $3.8 million.

In the past, the value of the SDR had been based on an average worth of the world's five major currencies, the U.S. dollar, the French franc, the British pound sterling, the Japanese yen, and the German mark. Since the introduction of the Euro on January 1, 1999, the German mark and the French franc valuations have been replaced with equivalent amounts of the Euro. According to current records, there exist nearly 212 billion SDRs (roughly $300 billion).

Stand-By-Arrangement—the IMF's method of providing a troubled member a line of credit for one to two years to support its reform programs

Extended Arrangements—the IMF's method of providing a troubled member a line of credit for three to four years to support its reform programs

Members in need of an IMF loan must first have their economic reform package approved by the Executive Directors of the IMF. This often helps to ensure that the country is genuinely attempting to resolve its balance of payment problems without violating the code of conduct, impinging upon the liquidity of those resources, or short-circuiting other countries' access to IMF aid. The two types of loan arrangements that are most often used by the IMF are the Stand-By-Arrangement and Extended Arrangement, which provide troubled members a line of credit to support reform programs of one to two years, or three to four years, respectively. Both are granted on the condition that the country maintains its program of policy adjustments. The IMF also charges

specific rates of interest and service fees, and requires that members repay their own currency that was drawn from the IMF pool, over a set time period. Again, since the IMF operates as a cooperative institution, member countries help decide how much of the IMF's pool of money to lend a fellow member in financial difficulty.

Where does the IMF get its money?
The greatest share of the IMF's pool of funds comes from the member countries' quota subscriptions, which was reported to be about $210 billion in January 1999. Only roughly half of these funds are actually used because all the member countries must pay their quotas with 75 percent of their domestic currency, and the only major currencies that are demanded by borrowers (the major convertible currencies) are the U.S. dollar, the Japanese yen, and the Euro. In other words, there is little outside demand for a country's currency if it is not a major convertible currency. With so many member countries and the uncertainty of future monetary crises, the IMF must make sure that it has an abundant source of funds, and quotas are not quite enough. The rest comes from the IMF's General Arrangements to Borrow (GAB), a line of credit with various governments and central banks around the world, which was established in 1962 and is now worth an estimated $24 billion. The IMF renews its GAB every five years and pays interest on its borrowings. As of this writing, the IMF has implemented an additional line of credit, called the New Arrangements to Borrow, which amounts to almost $40 to $45 billion.

On a Final Note: What is the difference between the IMF and the World Bank?
The IMF is sometimes confused with the World Bank because of its financial functions. Although the two are sister institutions, they actually espouse different goals. An important distinction to keep in mind is that the IMF focuses more on macroeconomic issues like exchange rate stabilization and international trade expansion, whereas the World Bank deals with countries on a more microeconomic level, especially with regard to poorer countries. The World Bank concentrates on issues of economic development and structural reform in impoverished nations. Since the economies of different countries are becoming ever more interconnected due to financial globalization and international trade, both the IMF and the World Bank have begun incorporating economic reform into their respective agendas. In fact, the two institutions have started to work quite closely in making funds available at extremely low interest rates to poor nations as they thoroughly restructure their weak economies. Their coordinated actions on this front are meant to eliminate the source of payments difficulties and pave the way for global economic progress.

microeconomic— relating to the branch of economics that examines individual decision-making at firms and households and the way they interact in specific industries and markets

ANSWER KEY

EASY QUESTIONS

1. The letters "IMF" stand for
   a) International Monetary Forum
   b) International Money Foundation
   c) Independent Manager of Finances
   d) International Monetary Fund

2. Who was one of the famous economists who proposed the creation of the IMF?
   a) John Henry Adams
   b) Francis Scott Key
   c) John Maynard Keynes
   d) J. Edgar Hoover

3. The IMF was founded in what year?
   a) 1935
   b) 1945
   c) 1955
   d) 1965

4. Where were the negotiations for the establishment of the IMF held?
   a) Cape Breton Island, Nova Scotia
   b) New Brighton, Minnesota
   c) Bretton Woods, New Hampshire
   d) New Britain, Connecticut

5. What is the name of the document which established the Bretton Woods par value system?
   a) The Articles of Agreement
   b) The Articles of Confederation
   c) The Articles of Bretton Woods
   d) The Articles of the IMF

6. What precious metal was the par value system based on?
   a) Platinum
   b) Gold
   c) Silver
   d) Nickel

7. What was one of the reasons for creating the IMF?
   a) Falling world currency prices
   b) Shrinking international trade
   c) Unstable world markets
   d) All of the above

8. The par value system is also called the
   a) Gold exchange standard
   b) Gold exchange value
   c) Gold value system
   d) Gold value standard

9. The par value system was replaced by a system called
   a) Flexible value system
   b) Floating exchange rate system
   c) Flexible currency system
   d) Floating value system

10. Which of the following is NOT considered a major convertible currency by the IMF?
   a) Swiss franc
   b) Japanese yen
   c) U.S. dollar
   d) French franc

MEDIUM QUESTIONS

1. Which of the following is NOT a main function of the IMF?
   a) Regulatory
   b) Diplomacy
   c) Financial
   d) Policy Advisory

2. What is the IMF's main goal?
   a) To gain full control of the world economy
   b) To act as a charity organization for developing nations
   c) To promote the smooth exchange of foreign currencies to facilitate trade among countries
   d) To educate countries about financial responsibility

3. In what year did the floating exchange rate system replace the par value system?
   a) 1977
   b) 1978
   c) 1979
   d) 1980

4. What does "SDR" stand for?
   a) Special Drawing Rights
   b) Standard Deductible Rate
   c) Special Donation Rules
   d) Standard Depreciation Rates

5. What is a Special Drawing Right?
   a) The IMF's system of laws and regulations
   b) The IMF's right to loan money
   c) The IMF's right to draw from a pool of funds
   d) The IMF's currency or assets

6. Decisions made by the IMF are conducted in which of the following ways?
   a) Majority rules vote
   b) Direct orders from one individual in charge
   c) Closed meeting of the Executive Board
   d) Unanimous vote

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7. What does it mean when countries are facing large current-account deficits?
   a) A country's exports exceed imports which increases government deficits.
   b) A country's exports exceed imports which decreases government deficits.
   c) A country's imports have experienced a large deficit.
   d) A country's imports exceed exports which increases government deficits.

8. If a member country refuses to fulfill its obligations, the IMF is allowed to
   a) Impose a stiff financial penalty
   b) Take military action
   c) Declare the member ineligible for loans
   d) Assume full control over that country's economic policy–making institution

9. What determines the voting power of an IMF member country?
   a) The amount of its quota subscription
   b) The population of that country
   c) The strength of that country's petition to vote
   d) The assessed educational level of that country's citizens

10. In 1998, which country had the greatest voting power in the IMF?
    a) Japan
    b) United States
    c) Germany
    d) France

DIFFICULT QUESTIONS

1. Why does the IMF give Special Drawing Rights to its member countries?
   a) To reward countries with excellent financial track records
   b) To encourage economic development
   c) To attempt to stabilize the exchange value of member country currencies
   d) To equalize the distribution of wealth between nations

2. Which four currencies are SDRs based on?
   a) The U.S. dollar, the Swiss franc, the Japanese yen, and the Italian lira
   b) The U.S. dollar, the Euro, the French franc, and the Canadian dollar
   c) The U.S. dollar, the German mark, the Euro, and the Swiss franc
   d) The U.S. dollar, the British pound sterling, the Euro, and the Japanese yen

3. What do the General Arrangements to Borrow (GAB) allow the IMF to do?
   a) To borrow money from the World Bank
   b) To borrow money from governments and central banks around the world
   c) To borrow money from governments and central banks only in the United States, Japan, Germany, France, and England
   d) To borrow money from individual persons around the world identified by the IMF as "having significant wealth"

4. Why is the GAB necessary?
   a) Because quota subscriptions are not enough to ensure that the IMF has enough money during crises
   b) Because the IMF needs a set of rules to govern its actions
   c) Because certain members that don't qualify for SDRs are only granted GABs
   d) Because it determines the percentage of borrowings that must be repaid in three years

5. What is one way in which the IMF's focus differs from that of the World Bank?
   a) The IMF focuses on microeconomic issues of coordinating private companies to finance poorer countries.
   b) The IMF dictates economic policy for countries that are not represented in the World Bank.
   c) The IMF lends to developing countries at high interest rates whereas the World Bank lends to industrialized countries at low interest rates.
   d) The IMF focuses on maintaining exchange rate stability and assisting countries that are facing severe debt problems. The World Bank focuses on economic development issues.

6. What is a moral hazard?
   a) A situation in which a country engages in activities that compromise the unspoken rules of moral conduct
   b) A situation in which the provision of insurance against risk encourages behavior that makes the risk more likely to occur
   c) A hazardous situation in which a country's economic policies place its citizens in a position of moral risk
   d) A hazardous situation in which the moral conduct of a country is illegal and grounds for expulsion from the IMF

7. Which of the following does NOT describe one of the three phases of an IMF consultation?
   a) The IMF team meets with private citizens of a member country to poll their economic concerns and publishes their findings in an IMF publication called the *World Economic Outlook*.
   b) After preparing a detailed report of its findings, the IMF team discusses specific economic issues with the IMF's Executive Board and Board of Directors.
   c) An IMF team meets with high-ranking government officials to ask questions about the country's economy.
   d) An IMF team travels to a country's capital to gather statistical data.

8. What is a balance of payments problem?
   a) A member country has difficulty balancing its accounts because its exports exceed its imports.
   b) A member country has difficulty balancing its payments to the IMF for past loans.
   c) A member country is unable to pay for what it imports from other countries because it hasn't taken in enough foreign money to do so.
   d) A member country is unable to adequately balance its payments between the IMF and the World Bank.

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9. Which of the following describes a function of the IMF's advisory role?
   a) It dictates specific economic policies to be implemented in a member country's ailing economy.
   b) It encourages governments to enact high tax rates for their citizens to decrease the immediate need for IMF and World Bank loans.
   c) It maintains and deals with members' financial transactions with the IMF.
   d) It advises the member country on private banking issues.

10. Which of the following is NOT a rationale of the financial assistance provided by the IMF?
   a) By helping a distressed member pay off its debts to another country, the IMF hopes to prevent long-term economic damage.
   b) By providing short-term financial assistance to a distressed member, the IMF hopes to ward off a chain reaction-like effect of economic recession among neighboring countries.
   c) By helping a distressed member pay off its debts to another country, the IMF hopes to prevent the country from implementing drastic domestic economic policies that may harm itself and other countries in the long-term.
   d) By providing short-term financial assistance to a distressed member, the IMF hopes to instill a sense of indebtedness and gratitude in the member so that they will be willing to pay a higher quota subscription in the future.

EASY QUESTIONS (10 CARDS)

The letters "IMF" stand for
a) International Monetary Forum
b) International Money Foundation
c) Independent Manager of Finances
d) International Monetary Fund

Who was one of the famous economists who proposed the creation of the IMF?
a) John Henry Adams
b) Francis Scott Key
c) John Maynard Keynes
d) J. Edgar Hoover

The IMF was founded in what year?
a) 1935
b) 1945
c) 1955
d) 1965

Where were the negotiations for the establishment of the IMF held?
a) Cape Breton Island, Nova Scotia
b) New Brighton, Minnesota
c) Bretton Woods, New Hampshire
d) New Britain, Connecticut

What is the name of the document which established the Bretton Woods par value system?
a) The Articles of Agreement
b) The Articles of Confederation
c) The Articles of Bretton Woods
d) The Articles of the IMF

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What precious metal was the par value system based on?
a) Platinum
b) Gold
c) Silver
d) Nickel

What was one of the reasons for creating the IMF?
a) Falling world currency prices
b) Shrinking international trade
c) Unstable world markets
d) All of the above

The par value system is also called the
a) Gold exchange standard
b) Gold exchange value
c) Gold value system
d) Gold value standard

The par value system was replaced by a system called
a) Flexible value system
b) Floating exchange rate system
c) Flexible currency system
d) Floating value system

Which of the following is NOT considered a major convertible currency by the IMF?
a) Swiss franc
b) Japanese yen
c) U.S. dollar
d) French franc

question card set #2

MEDIUM QUESTIONS (10 CARDS)

Which of the following is NOT a main function of the IMF?
a) Regulatory
b) Diplomacy
c) Financial
d) Policy Advisory

What is the IMF's main goal?
a) To gain full control of the world economy
b) To act as a charity organization for developing nations
c) To promote the smooth exchange of foreign currencies to facilitate trade among countries
d) To educate countries about financial responsibility

In what year did the floating exchange rate system replace the par value system?
a) 1977
b) 1978
c) 1979
d) 1980

What does "SDR" stand for?
a) Special Drawing Rights
b) Standard Deductible Rate
c) Special Donation Rules
d) Standard Depreciation Rates

What is a Special Drawing Right?
a) The IMF's system of laws and regulations
b) The IMF's right to loan money
c) The IMF's right to draw from a pool of funds
d) The IMF's currency or assets

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Decisions made by the IMF are conducted in which of the following ways?

a) Majority rules vote
b) Direct orders from one individual in charge
c) Closed meeting of the Executive Board
d) Unanimous vote

What does it mean when countries are facing large current-account deficits?

a) A country's exports exceed imports which increases government deficits.
b) A country's exports exceed imports which decreases government deficits.
c) A country's imports have experienced a large deficit.
d) A country's imports exceed exports which increases government deficits.

If a member country refuses to fulfill its obligations, the IMF is allowed to

a) Impose a stiff financial penalty
b) Take military action
c) Declare the member ineligible for loans
d) Assume full control over that country's economic policy making institution

What determines the voting power of an IMF member country?

a) The amount of its quota subscription
b) The population of that country
c) The strength of that country's petition to vote
d) The assessed educational level of that country's citizens

In 1998, which country had the greatest voting power in the IMF?
a) Japan
b) United States
c) Germany
d) France

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DIFFICULT QUESTIONS (10 CARDS)

✂

Why does the IMF give Special Drawing Rights to its member countries?

a) To reward countries with excellent financial track records
b) To encourage economic development
c) To attempt to stabilize the exchange value of member country currencies
d) To equalize the distribution of wealth between nations

Which four currencies are SDRs based on?

a) The U.S. dollar, the Swiss franc, the Japanese yen, and the Italian lira
b) The U.S. dollar, the Euro, the French franc, and the Canadian dollar
c) The U.S. dollar, the German mark, the Euro, and the Swiss franc
d) The U.S. dollar, the British pound sterling, the Euro, and the Japanese yen

What do the General Arrangements to Borrow (GAB) allow the IMF to do?

a) To borrow money from the World Bank
b) To borrow money from governments and central banks around the world
c) To borrow money from governments and central banks only in the United States, Japan, Germany, France, and England
d) To borrow money from individual persons around the world identified by the IMF as "having significant wealth"

Why is the GAB necessary?

a) Because quota subscriptions are not enough to ensure that the IMF has enough money during crises
b) Because the IMF needs a set of rules to govern its actions
c) Because certain members that don't qualify for SDRs are only granted GABs
d) Because it determines the percentage of borrowings that must be repaid in three years

What is one way in which the IMF's focus differs from that of the World Bank?

a) The IMF focuses on microeconomic issues of coordinating private companies to finance poorer countries.
b) The IMF dictates economic policy for countries that are not represented in the World Bank.
c) The IMF lends to developing countries at high interest rates whereas the World Bank lends to industrialized countries at low interest rates.
d) The IMF focuses on maintaining exchange rate stability and assisting countries that are facing severe balance of payments problems. The World Bank focuses on economic development issues.

What is a moral hazard?

a) A situation in which a country engages in activities that compromise the unspoken rules of moral conduct
b) A situation in which the provision of insurance against risk encourages behavior that makes the risk more likely to occur
c) A hazardous situation in which a country's economic policies place its citizens in a position of moral risk
d) A hazardous situation in which the moral conduct of a country is illegal and grounds for expulsion from the IMF

Which of the following does NOT describe one of the three phases of an IMF consultation?

a) After preparing a detailed report of its findings, the IMF team discusses specific economic issues with the IMF's Executive Board and Board of Directors.
b) The IMF team meets with private citizens of a member country to poll their economic concerns and publishes their findings in an IMF publication called the *World Economic Outlook*.
c) An IMF team meets with high-ranking government officials to ask questions about the country's economy.
d) An IMF team travels to a country's capital to gather statistical data.

What is a balance of payments problem?

a) A member country is unable to pay for what it imports from other countries because it hasn't taken in enough foreign money to do so.
b) A member country has difficulty balancing its accounts because its exports exceed its imports.
c) A member country has difficulty balancing its payments to the IMF for past loans.
d) A member country is unable to adequately balance its payments between the IMF and the World Bank.

Which of the following describes a function of the IMF's advisory role?

a) It dictates specific economic policies to be implemented in a member country's ailing economy.
b) It encourages governments to enact high tax rates for their citizens to decrease the immediate need for IMF and World Bank loans.
c) It maintains and deals with members' financial transactions with the IMF.
d) It advises the member country on private banking issues.

Which of the following is NOT a rationale of the financial assistance provided by the IMF?

a) By helping a distressed member pay off its debts to another country, the IMF hopes to prevent long-term economic damage.
b) By providing short-term financial assistance to a distressed member, the IMF hopes to ward off a chain reaction-like effect of economic recession among neighboring countries.
c) By helping a distressed member pay off its debts to another country, the IMF hopes to prevent the country from implementing drastic domestic economic policies that may harm itself and other countries in the long-term.
d) By providing short-term financial assistance to a distressed member, the IMF hopes to instill a sense of indebtedness and gratitude in the member so that they will be willing to pay a higher quota subscription in the future.

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LIFELINE

LIFELINE

LIFELINE

50/50

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SCORE SHEET

	TEAM 1	TEAM 2	TEAM 3	TEAM 4
EASY 1 point each				
MEDIUM 5 points each				
DIFFICULT 10 points each				
Total points				

handout #3

TEAM QUIZ RULES

This team quiz activity is loosely based on the television game show "Who Wants to Be a Millionaire?" Specific instructions follow:

1. Teams will select one member at a time to represent the team, but must take turns so that all team members have equal participation throughout the game. Teams must select the contestant BEFORE the question is revealed. The contestant will answer the question for the team using his or her set of answer cards A–D.

2. The teacher (or designated game show host) will display and read the entire question card on the transparency.

3. From the time the last answer is read, contestants have 30 seconds to answer the question. They must do so by selecting the answer card that corresponds to what he or she thinks is the correct answer.

4. When the 30 seconds are up, all of the contestants will reveal their answer cards to the class at the same time, to prevent last-minute answer changes.

5. Correct answers earn the team points as follows:
   Easy=1 point
   Medium=5 points
   Difficult=10 points

   Incorrect answers earn negative points.

6. Each team has a total of three "lifeline" cards and one "50/50 card" to use in cases where individual contestants feel they need additional help.

   The "LIFELINE" card allows contestants to consult with their teammates, but they must do so within the 30-second time limit.

   The "50/50" card allows contestants to choose from a narrowed field of answers in which the teacher eliminates two of the multiple choice answers that are incorrect, leaving the contestant with a 50 percent chance of guessing the correct answer within the 30-second time limit. NOTE: IF A CONTESTANT CHOOSES THIS OPTION, IT ALSO BENEFITS THE OTHER THREE CONTESTANTS.

   Each help card can only be used once. Choose wisely.

Good luck!

IMF Brochure Instructions

Group Task

Your group will create an informational brochure promoting the IMF. This will be a tri-fold brochure on an 8.5" x 11"piece of paper. You may use both sides.

Your goal is to summarize the contents of Handout #1, *The International Monetary Fund*. The purpose of this brochure is to apply what you have read about the IMF and reprocess it in a creatively concise yet thorough manner. Be sure to cover the following in your brochure:

1) the purpose of the IMF
2) the three functions of the IMF
3) rights and responsibilities of IMF member nations

Your brochure will be evaluated on its creativity, succinctness, attractiveness, and accuracy.

Lesson Three

A Glance at the Crisis

Organizing Questions

- How were the East Asian countries affected by the 1997–98 financial crisis?
- What distinguishes the original "tiger economies" of Hong Kong, Singapore, South Korea, and Taiwan from those of Thailand, Indonesia, the Philippines, and Malaysia?
- How are the East Asian economies faring at present?

Introduction

Now that the students have familiarized themselves with the context and general events of the 1997–98 Asian financial crisis and the purposes of the IMF, Lesson Three provides them with an opportunity to combine and apply the knowledge from the two previous lessons more specifically. On their own, they will examine the similarities and differences in the economic problems of the East Asian countries. The goal of this lesson is to engage them in an activity that roughly simulates the IMF consultation process. The students are asked to do some group research on their assigned East Asian countries as well as present their conclusions to the rest of the class. The final exercise in this lesson is an update session in which the students gather and present their findings regarding the current status of their assigned countries and the IMF's recent activities.

Objectives

knowledge

- to learn about some specific economies affected in the 1997–98 Asian financial crisis
- to learn how the IMF helped the more troubled East Asian countries to develop economic reform plans

attitude

- to comprehend the interconnectedness of strong and weak economies in East Asia
- to appreciate the challenges that these economies have faced and how they have attempted to recover in the aftermath of the crisis

skill

- to formulate thoughtful questions about the strengths and weaknesses of various East Asian economies and their efforts at structural reform
- to make reasonable inferences about the current state of economic affairs in this geographical region
- to work in small and large groups to make decisions based on a given set of criteria

lesson three

Materials

- Teacher Information Sheet #1, *A Look at the "Tiger" and "Tiger Cub" Economies of Asia*
- Teacher Information Sheet #2, *Major Economic Concerns in Asia, 1997–98*
- Teacher Information Sheet #3, *IMF-Approved Economic Reforms*
- 10 Resource Cards
- Activity Card #1a, *Crisis in the East!*
- Activity Card #1b, *Assessing Economic Reform Plans*
- Activity Card #2a, *IMF Asian Crisis Action Committee*
- Activity Card #2b, *Loan Guidelines*
- Activity Card #2c, *IMF Loan Worksheet*
- Activity Card #3, *Final Report*
- 6 pieces of poster board
- An assortment of colored and white paper
- Colored markers, pens, pencils
- Scissors, glue, tape

Time

At least 4 class periods

Teacher Preparation

1. Make 2 copies of each Resource Card and cut along the dotted line of each card to create 2 full sets of 10 cards.
2. Make 10 copies of Activity Cards #1a–b.
3. Make 5 copies of Activity Cards #2a–c.
4. Make 10 copies of Activity Card #3.
5. Read through the Teacher Information Sheets thoroughly.

Procedure Part One

1. Inform students that in this lesson they will be doing a more in-depth study of the Asian financial crisis by examining how 10 Asian countries fared during this time and what role the IMF played in their efforts at economic recovery.

2. Select five students to play the role of members of the IMF Executive Board. Distribute Activity Cards #2a–c and one set of the 10 Resource Cards to this group.

3. Divide the rest of the class into 10 groups. These groups will assume the role of economic policymakers in 10 Asian countries trying to mitigate the effects of the financial crisis that gripped Asia in September 1997. Distribute one copy of Activity Card #1a and one Resource Card (that is, information about one country) to each group. (Inform students that Hong Kong is not a country, but rather a Special Administrative Region (SAR) of the People's Republic of China.)

4. Each of these 10 groups should prepare to give a presentation to the IMF Executive Board according to the directions stipulated on Activity Card #1a. Inform students that all 10 groups are vying for 3 available loans.

5. While the 10 groups are doing their research, the IMF Executive Board should also be doing their own research on these countries so they can make better-informed decisions.

6. Allow students at least one full class period to prepare.

7. Each group has 5–7 minutes to present its case to the IMF Executive Board. Before presentations begin, distribute one copy of Activity Card #1b to each student in these 10 groups. Instruct students to fill in this chart as other groups present.

8. The IMF group members should have their IMF Loan Worksheets ready to fill out while groups are presenting.

9. After all presentations have finished, allow the IMF Executive Board group members 5–10 minutes to consolidate their evaluations and decide which of the three countries will receive an IMF loan. (Each of the five members of this group will have taken notes on two of the 10 countries.)

10. Allow the group 10 minutes to present its reasons for awarding the three loans and why these three countries were more eligible than the other seven.

11. Conclude this activity by engaging students in a discussion using the following questions as a guide:
    - Which countries seemed to be in the best economic shape? The worst economic shape?
    - What did the IMF Executive Board seem to be looking for in determining loan eligibility?
    - Do the proposed reform packages seem to be similar? Why or why not?
    - What accounts for differences among reform packages? Is it the economic structure of the country? The extent of damage caused by the financial crisis? Different culture?
    - Do these packages have a realistic chance of working? How might the public react to the proposed measures? Are the plans politically feasible?
    - What effect might these changes have on the economy as a whole, and on the average resident in particular?
    - What do modern economies that are considered prosperous share in common?
    - What reforms would you suggest to strengthen a weak economy?

Part Two

1. The culminating activity of the entire curriculum unit requires students, in the same small groups, to continue researching their assigned country to produce a final report of that country's economic status before, during, and after the financial crisis. Distribute copies of Activity Card #3, which explains the task, to each group.

2. For this activity, instruct the IMF Executive Board members to select one of the two countries they researched in the previous activity, and to join that particular group for this activity.

3. Allow students at least two full class periods to conduct research. This activity can also be assigned as a long-term research project. Allow each group 10 minutes to present its final report to the class.

4. Debrief the lesson and curriculum unit by engaging students in a discussion using the following questions as a guide:
   - How were Asian countries affected by the 1997–98 Asian financial crisis?
   - Did different countries fare differently? Why or why not?
   - What were some of the economic reform packages proposed by the countries in real life? Did students come up with similar reform packages?
   - Did the reform packages cause a recession? Did they affect the country's monetary supply, interest rates, and GDP? Did they address short- and long-term economic problems and suggest solutions?
   - Did countries provide safety nets (welfare, public assistance, etc.) to aid the unemployed and individuals facing severe debt?
   - How did the public view these economic reforms in real life?
   - Did any economic reform packages affect neighboring countries? If so, did they affect the countries directly or indirectly?
   - What role did the IMF play in the Asian financial crisis?
   - Do you think the IMF is a necessary institution?
   - What do you think might have happened if the IMF did not exist and had not been available to help out during a crisis such as the Asian financial crisis of 1997–98?

teacher information sheet #1

A Look at the "Tiger" and "Tiger Cub" Economies of Asia

These summaries should give the teacher some idea of the general strengths and weaknesses of the seven "Tiger" and "Tiger Cub" economies of Asia, along with a description of the kinds of economic goals the IMF pursues when it helps a member experiencing serious balance of payment problems. China's and Japan's economies are described in Teacher Information Sheet #2, *Major Economic Concerns in Asia, 1997–98*.

"Tiger" Economies (Hong Kong, Taiwan, Singapore, South Korea)

Hong Kong: Long before the crisis hit Asia, Hong Kong was recognized for its strong currency peg to the U.S. dollar as well as its open and free-market economy. Although it did feel the ripple effects of the crisis, Hong Kong survived the financial meltdown because of its disciplined market, enormous foreign-exchange reserves, highly flexible wages and price levels (which made it less prone to devalue its currency to maintain competitiveness), and its sound banking system with high capital-adequacy rations (money reserve requirements which prevented the banks from going bust). When currency speculators attempted to attack and devalue the Hong Kong dollar, the Hong Kong government preemptively intervened in the stock market and pushed up stock prices (thus helping to prop up the currency value) by purchasing a vast amount of stocks. However, this was only temporary and Hong Kong endured its share of losses in the market. During the crisis, its output contracted about 57 percent in 1998. Although Hong Kong was relatively strong when compared to the struggling emerging markets, it faced high interest rates, deflation (continual decrease in price levels), and weakened domestic demand.

Taiwan: Taiwan was lauded for its large foreign-exchange reserves and current-account surplus, and some economists believe that it remained the sturdiest in the crisis. Thanks to a robust and disciplined banking sector, it allowed interest rates to be set by the markets. Taiwan had to its credit a record of limited foreign borrowing, periodic government intervention when it was necessary, and flexible industrial policies that adjusted well to the changing conditions of the market. During the crisis, it chose to devalue its currency before the other countries did in order to increase the competitiveness of its exports. Taiwan also managed to defend its currency successfully against aggressive speculators because of its large foreign-exchange reserves.

Singapore: In the period right before the Asian financial crisis, Singapore was very much like its sibling tigers Hong Kong and Taiwan. Singapore boasted a huge current-account surplus, a robust and well-regulated financial sector, and a fairly free and open market despite the level of government intervention. It had to its credit a relatively clean government and reliable legal system, compared to those of its immediate neighbors. Although its public sector was large and tightly controlled by the government, for the most part, it remained free of corruption. However, it did not emerge unscathed in the interim between 1997 and 1998. It was hurt by the crisis in Malaysia, and its currency dropped as a result. During the latter half of 1998, the central bank had to implement contractionary monetary policies, and its economy went through downward exchange rate adjustments and weak consumer activity. But positive growth resumed in early 1999.

South Korea: South Korea is considered one of the original "tiger economies" and surpasses the other three in size. Just like its neighbors, it experienced rapid growth rates in the years preceding the crisis. But it had a number of problems with its economic infrastructure. The South Korean government directed its banks to lend to particular sectors of the economy at remarkably low rates. Since corporations and banks expected the government to bail them out at the first signs of trouble, this encouraged irresponsible investment practices and financial excesses. This included shady dealings among governments, banks, and *chaebols*. *Chaebols* or conglomerates represented one of the unique aspects about the financial structure of South Korea. Due to a panic among foreign investors who feared that South Korean firms and banks would soon go bankrupt, foreign lending came to a sudden halt, and as a result, its markets crashed. Its currency depreciated further. Debts increased, companies became insolvent, and banks also went bust. Furthermore, the lax bank supervision, moral hazards and collusion among the government, insolvent *chaebols*, and the banks hampered economic recovery.

"Tiger Cub" Economies (Thailand, Malaysia, Indonesia)

Thailand's economy was the first to stumble. Like most of the other Asian economies, Thailand maintained a currency peg to the U.S. dollar. Pegged exchange rates kept banks from raising domestic interest rates in order to curb an explosion in domestic credit. This also gave banks a false sense of security and thus led to frequent borrowing in dollars at interest rates much lower than the domestic Thai rates. With dollar borrowing made so cheap, investment grew at a feverish pace, and debt to foreign banks likewise soared. International investors were lured by the high interest rates in Thailand. Lenders thought they could get greater returns for their investments in the Thai stock, currency, and real estate markets.

This boom also stimulated a growth in imports. In this overheating economy, Thai imports increased, as did the dollar interest rates. Thus, the appreciating dollar pulled up other pegged Asian currencies. As the price of the Thai baht and other currencies rose with the dollar, the manufactured goods produced in these countries became more expensive. This severely weakened their exports and exacerbated the current-account deficit.

The earlier wave of currency devaluations in Japan and China had left the Thai baht and other Asian currencies very weak. "The pressure for devaluation of the baht increased in 1996 and 1997 when the Japanese yen declined by 35 percent relative to the dollar. Since Japan is Thailand's major trading partner, the sharp rise in the value of the dollar (and therefore of the baht) relative to the yen made Thai products more expensive and therefore less competitive and pointed to even larger trade deficits in the future." (Feldstein, 1998: 23) The current-account deficit pushed up the price of the baht and made it the target of currency speculators. Even though the Thai government attempted to defend the currency by selling its foreign reserves in exchange for Thai baht (which would then be removed from circulation and placed in the vaults of the central bank), it was all in vain because the government quickly depleted its foreign exchange reserves. It was forced to allow the baht to float, and this led to a staggering devaluation of more than 40 percent. Investors who were concerned about the firms' inability to pay off their loans reduced their lendings.

teacher information sheet #1

The currency meltdown was so severe in Thailand that the economy shrank 10 percent in 1998 after an average annual growth rate of 8 percent two years prior. Thus, financial resources soon dried up, panic filled the air, investors pulled out of their investments, and the Thai exchange and stock markets crashed. The property and investment bubble had popped. It was then that the Thai government pleaded to the IMF for assistance.

unhedged—a situation in which an investment in a set of risky assets is not balanced by less risky assets to diminish or spread out losses

What some economists jokingly termed Thai "bahtulism" quickly spread to other East Asian countries namely, Malaysia, Indonesia, and the Philippines. After the Thai currency meltdown, it became sufficiently clear that cheap, unhedged borrowing, inefficient and unsupervised financial systems, weak bankruptcy and secured-lending laws, and corrupt ties among the governments, banks, and firms had been a large part of the problem in East Asia.

Malaysia and Indonesia were both laden with similar financial troubles of lax banking supervision, mounds of unhedged foreign debt, and corruption among the heads of government, banks, and corporations. As Thailand was in the throes of its currency meltdown, Indonesia's President Suharto faced depleting foreign exchange reserves as the central bank strove to fight off aggressive currency speculators. The government-imposed monopolies, the import restrictions, and opaque business practices did little to improve the economic state of Indonesia or Malaysia. In both countries, the governments' subsidized loans and the inefficient lending and business practices caused severe economic distortions. To make matters worse, failing firms and banks were insulated from market forces. Without such forces, troubled and inefficient businesses and banks could not be weeded out to allow smaller but more efficient ones to establish a foothold in the market.

In retrospect, many economists claim that the 1997–98 Asian financial crisis was inevitable. The irrational exuberance demonstrated by the investors in East Asia fed the booming economies, which in turn contributed to an environment of complacency, corruption, and excess. Misguided attempts to maintain the high peg to the dollar only made financial matters worse. Large current-account deficits led to sharp declines in the local currency values when foreign creditors and domestic investors became concerned that the borrowers would be unable to repay their debts. The crash of the stock and exchange markets and the wave of investor panic that swept through East Asia followed a series of ignored problems that beset the financial sectors in the developing market economies of Thailand, Indonesia, Malaysia, and the Philippines.

teacher information sheet #2

MAJOR ECONOMIC CONCERNS IN ASIA, 1997–98*

China

- economic planning difficult due to unreliable statistics
- growth not rebounding at expected rate
- inefficient state-owned industries are losing money and hampering economic growth
- declining foreign investment
- banks in debt
- rising unemployment may lead to social unrest
- recent devaluations in East Asian countries have hurt China's exports
- overcapacity; inventories of industrial goods are too high

Hong Kong

- large stock market crash in October due to the Asian crisis
- currency speculators have tried to attack the Hong Kong dollar; some academics and market experts suggest ending the currency peg to the U.S. dollar
- widening gap between the rich and the poor
- some fear that China will take over key sectors of Hong Kong's economy

Indonesia

- currency has undergone a huge depreciation and some fear it may fall further
- capital is leaving the country
- large current-account deficits
- economic downturn has led to many layoffs and a high unemployment rate
- crop damage due to drought
- investments and loans have gone to unproductive industries
- endemic corruption at all levels of society and government
- high inflation
- liquidity crunch hampers potential economic growth
- political turmoil and civil unrest
- declining output due to disruption in production, exports, and supply channels
- corporations heavily in debt
- real GDP falls by roughly 15 percent; recession
- rupiah depreciated 85 percent from June 1997

Japan

- shrinking economy (negative GDP growth)
- slow domestic demand
- sinking stock market
- disturbingly large budget deficit
- banks have made too many bad loans, leading to several bankruptcies
- scandals have plagued financial companies

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* Wong, Kar-yiu. (1998). *The Asian Crisis: What Has Happened and Why?*

teacher information sheet #2

Malaysia
- ringgit has depreciated considerably since summer 1997
- large current-account deficit
- investment bubble in the real estate and stock markets
- Kuala Lumpur stock market falling
- fewer infrastructure projects, leading to slower economic growth

Philippines
- fear that recession may soon ensue
- peso dropping in value
- high unemployment rate (10.6% in June 1997)
- flight of investment from the country
- trade deficit
- economy vulnerable to actions of foreign investors
- low-wage competition from other countries may hurt export industries

Singapore
- economic downturn in surrounding Southeast Asian countries means decrease in trade and slower economic growth for Singapore
- slight drop in currency's value
- rising costs make Singapore's products less competitive, thus hurting exports
- sluggish stock market

South Korea
- strikes and other large-scale labor unrest
- several large *chaebols* have filed for bankruptcy because of too much debt
- depreciating currency
- steep drop in foreign lending
- plunging stock market
- fears of an impending financial crisis due to bad loans and rising debt
- large foreign debt (balance of payments difficulties)

Taiwan
- sudden currency devaluation in October
- rumored traces of corruption and overspending in infrastructure projects
- economic downturns in the rest of the region hurt exports

Thailand
- high interest rates
- low consumer demand
- enormous private foreign debt
- huge current-account deficit
- plunging currency
- corrupt financial sector lacking oversight
- bad investments
- real estate bubble burst

teacher information sheet #3

IMF-Approved Economic Reforms

The events of the 1997–98 Asian financial crisis were dire enough to spread to Russia, Latin America, and other emerging markets. As was covered in Lesson One, some significant factors in the Asian financial crisis were the intense influx of foreign capital and lending, massive currency depreciations, and the sudden panic by investors, which caused them to pull out of their investments in a mad rush. A similar set of events occurred in Russia and Brazil. Sudden investor panic caused a wave of bankruptcies among banks and corporations in most of these emerging markets. When the East Asian countries such as Thailand, Indonesia, and Malaysia faced a shortage of foreign currency reserves, which had been spent to maintain their fixed exchange rates at high levels, it eventually became too difficult to pay off their debts to foreign countries. So they appealed to the IMF for financial assistance. Since the East Asian economies that were hit the hardest shared several macroeconomic weaknesses with those of Russia and Brazil, it will suffice to list some of the more relevant IMF-approved economic reforms that applied to several countries in crisis during this period between 1997 and 1998.

General Suggested Reforms

- strengthen the social safety net (unemployment insurance, public assistance, etc.); improve and implement appropriate fiscal policies
- increase government spending to help economy expand; shorten or alleviate recession
- coordinate sound monetary policies with fiscal policies to keep economy in check or stimulate consumption, depending on the economic status of the country
- restructure banks and corporations; enforce greater transparency in accounting methods
- strengthen bank and corporate regulation and supervision; implement policies to improve lending and borrowing practices; implement better bankruptcy policies
- encourage private sector involvement in preventing and resolving future financial crises
- promote competition, trade liberalization, lessen government intervention
- privatize companies and reduce number of government-owned sectors/firms
- change from fixed to flexible exchange rates

Note: A more comprehensive description of the IMF and its responses can be found on its website *<http://www.imf.org>*.

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CHINA

Full Name:	People's Republic of China
Capital:	Beijing
Population:	1.2 billion
Density:	129/km.^{2}
Area:	9.6 million km.^{2} (slightly smaller than the USA)
Head of State:	President Jiang Zemin, Premier Zhu Rongji
Government:	Communist State/Single-Party Republic
Currency:	Renminbi (RMB) or yuan
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 8.16 RMB 1998 = 8.28 RMB

HONG KONG

Full Name:	Hong Kong Special Administrative Region (Hong Kong SAR or HKSAR)
Capital:	Victoria
Population:	6.9 million
Density:	5,800/km.^{2}
Area:	1,084 km.^{2} (6 times the size of Washington, D.C.)
Head of State:	President Jiang Zemin, Chief Executive Tung Chee-hwa (since 1 July 1997)
Government:	Special Administrative Region of China (dependent territory of UK before July 1997)
Currency:	Hong Kong dollar
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 7.73 HK dollars 1998 = 7.73 HK dollars

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INDONESIA

Full Name:	Republic of Indonesia
Capital:	Jakarta
Population:	211 million
Density:	108/km.^{2}
Area:	1.9 million/km.^{2} (about 3 times the size of Texas)
Head of State:	President General Suharto (1998), President B. J. Habibie (1999), President Abdurrahman Wahid (2000)
Government:	Republic/Multi-Party Republic
Currency:	Rupiah
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 2,357 rupiah 1998 = 7,600 rupiah

JAPAN

Full Name:	Japan
Capital:	Tokyo
Population:	125.9 million
Density:	333/km.^{2}
Area:	377,750 km.^{2} (slightly smaller than California)
Head of State:	Emperor Akihito, Prime Minister Ryutaro Hashimoto (1996), Prime Minister Keizo Obuchi (1998), Prime Minister Yoshiro Mori (2000)
Government:	Constitutional Monarchy
Currency:	Yen
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 121.57 yen 1998 = 115.05 yen

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MALAYSIA

Full Name:	Malaysia
Capital:	Kuala Lumpur
Population:	20.6 million
Density:	62/km.^{2}
Area:	329,758 km.^{2} (slightly larger than New Mexico)
Head of State:	Tuanku Jaafar Ibni-Al-Marhum, Prime Minister Datuk Seri Mahathir bin Mohamad
Government:	Federal Constitutional Monarchy
Currency:	Ringgit
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 2.49 ringgit 1998 = 3.81 ringgit

PHILIPPINES

Full Name:	Republic of the Philippines
Capital:	Manila
Population:	77 million
Density:	257/km.^{2}
Area:	300,000 km.^{2} (slightly larger than Arizona)
Head of State:	President Fidel Valdes Ramos (1997), President Joseph Estrada (1998)
Government:	Republic
Currency:	Philippine peso
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 26.28 Philippine peso 1998 = 40.40 Philippine peso

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SINGAPORE

Full Name:	Republic of Singapore
Capital:	Singapore
Population:	3.5 million
Density:	5,494/km.^{2}
Area:	636 km.^{2} (about 3.5 times the size of Washington, D.C.)
Head of State:	President Ong Teng Cheong (1993), President Sellapan Ramanathan Nathan (1999) Prime Minister Goh Chok Tong
Government:	Multi-Party Republic
Currency:	Singapore dollar
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 1.45 Singapore dollars 1998 = 1.62 Singapore dollars

SOUTH KOREA

Full Name:	Republic of Korea
Capital:	Seoul
Population:	47 million
Density:	474/km.^{2}
Area:	99,016 km.^{2} (slightly larger than Indiana)
Head of State:	President Kim Young Sam (1997), President Kim Dae Jung (1998), Prime Minister Kim Jong Pil (1998), Prime Minister Park Tae Joon (2000)
Government:	Single-Party Republic
Currency:	Won
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 831.10 won 1998 = 1,321 won

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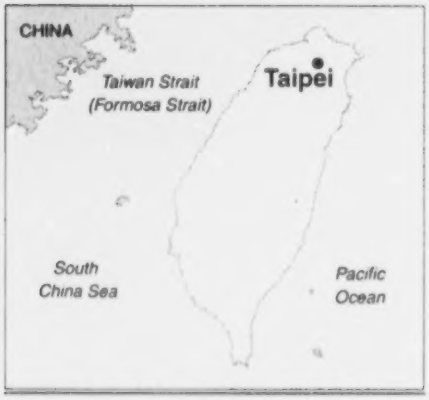

TAIWAN

Full Name:	Republic of China
Capital:	Taipei
Population:	21.7 million
Density:	604/km.^{2}
Area:	36,002 km.^{2} (about the size of Maryland and Delaware combined)
Head of State:	President Li Teng-hui (1999), President Chen Shui-bian (2000), Premier Vincent Siew (1997)
Government:	Multiparty Democratic Regime
Currency:	New Taiwan dollar (NT dollar)
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 27.44 NT dollars 1998 = 32.62 NT dollars

THAILAND

Full Name	Kingdom of Thailand
Capital:	Bangkok
Population:	59.8 million
Density:	116/km.^{2}
Area:	513,115 km.^{2} (about twice the size of Wyoming)
Head of State:	King Bhumibol Adulyadej (Rama IX), Prime Minister Chavalit Yongchaiyudh (1996–97), Prime Minister Chuan Leekpai (1997)
Government:	Constitutional Monarchy
Currency:	Baht
Exchange Rate:	**(equivalent to $1 U.S.)** 1996 = 25.40 baht 1998 = 36.40 baht

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activity card #1a

CRISIS IN THE EAST!

SEPTEMBER 1997

Thailand's economic crisis has caused financial panic throughout much of East Asia. Your country's leader has called an emergency meeting of all economic experts in an attempt to avert further chaos. As a leading economist, you are asked to decide whether to ask the IMF Executive Board for assistance. The Board is prepared to grant you one of three available loans if you need one and if you can convince the members of the direness of your economic situation and that the money will be spent efficiently. The Executive Board members have requested that all countries present a thorough synopsis of their economic situation in order to determine loan eligibility.

Your Task

Use all available resources (newspapers, magazines, Internet, etc.) for your research. Be sure to cite these sources. Your presentation should be 5–7 minutes in length. Each member of your group must speak for at least one minute. You may present your research in any way you choose (using visuals, overheads, pictures, videotape, charts, etc.), as long as you address all of the following topics in your presentation:

1. What is the "current" (September 1997) status of your economy? (Or for greater scope, what are the country's ostensible macroeconomic problems in 1997? What is the status of consumption, investment, government spending, and net exports?)
2. What are your economy's major weaknesses at the moment? (Is the economy facing inflation? recession? high interest rates? high taxes?)
3. Does your country need aid? Why or why not?
4. If your country needs aid, how will you use the money to reform your economy?
5. How will you prove to the Executive Board that you can follow up on your resolutions?

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ASSESSING ECONOMIC REFORM PLANS

COUNTRY or REGION	CURRENT STATUS	WEAKNESSES	TARGET AREAS FOR AID
China			
Hong Kong SAR			
Indonesia			
Japan			
Malaysia			
Philippines			
Singapore			
South Korea			
Taiwan			
Thailand			

activity card #2a

IMF Asian Crisis Action Committee

The daily IMF responsibilities fall into the hands of representatives who form its Executive Board. These representatives from the member countries form a liaison between their governments and the IMF. In this activity, you are five members of the IMF's Executive Board. You have been assigned to a special Asian Crisis Action Committee as the financial crisis now grips Asia. The IMF has placed you in charge of approving or denying IMF aid to East Asian countries subject to their need and their ability to use the money prudently. You will listen to presentations from 10 East Asian countries before making your decision to grant loans to three of these countries. The IMF Loan Guidelines are provided in Activity Card #2b.

1. There are 10 countries that will be presenting to you. Since there are five people in your group, decide which two countries each of you would like to represent. You will focus your attention on these two countries for the duration of the activity.

2. With your fellow board members, carefully review the Loan Guidelines so that you will be able to understand and decide how to appropriately assess a country's possible need for an IMF loan while the country groups are presenting.

3. While the country groups are doing their research, do your own research on the two countries you have chosen to represent so that you will have some background information to help you understand their presentation better. This will also help you recognize whether the situation is being represented accurately in the group presentations, which is an important factor in determining loan eligibility. Refer to the Resource Cards for basic facts of each country. Use all other available resources for your research (newspapers, magazines, Internet, etc.).

4. While the country groups are presenting, take notes on the IMF Loan Worksheet. You will have time to tally up points after the presentations are finished.

5. At the end of all the presentations, you will have 5–10 minutes to total up the points. The three teams with the highest number of points will receive the three IMF loans.

6. Select one member of your Executive Board to reveal the decisions to the class (i.e., which three countries will receive the loans and why they were more eligible than the other seven countries). You have 10 minutes to present.

LOAN GUIDELINES

Criteria	Indicators
Necessity	• Availability of foreign currency reserves • Status of federal budget • Difficulty of raising funds • Crisis has affected total population
Severity of crisis	• Level of interest rates • Level of economic growth • Unemployment rate • Value of currency • State of net exports
Ability to use funds prudently	• Corruption level • Where borrowed money has been spent • Predominance of competitive industries vs. state-owned enterprises
Commitment to reform	• Government commitment to free market practices • Government implementation of policies to mitigate economic troubles • Plans emphasize long-term stability • Degree of government interference in market

Points	Description
3	All the criteria are met
2	Most of the criteria (two or three) are met
1	Only one or two of the criteria are met

IMF LOAN WORKSHEET

While the country groups are presenting their appeals for an IMF loan, jot down notes in the chart below. After all 10 groups have presented, you will have 5–10 minutes to use the Loan Guidelines to help you tally up the points to determine which three groups will receive IMF loans.

COUNTRY:	TAKE NOTES IN THE SPACES BELOW	POINTS	TAKE NOTES IN THE SPACES BELOW	POINTS
Necessity				
Severity of Crisis				
Ability to use funds prudently				
Commitment to reform				
Total points				

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FINAL REPORT

With your group members, research and prepare a report of your assigned country's economic history from January 1998 to the present. You will be responsible for covering the following points:

- Provide a summary of the country's 1997 economic status (use your research from the previous activity).
- Document major economic measures or reforms, if any, that the country took to recover from the 1997–98 Asian financial crisis.
- Was the IMF involved in the country's financial recovery? If so, why did the country turn to the IMF for assistance?
- If the IMF did provide financial assistance, describe the key features of the economic reform package and the process by which it was developed and approved.
- How did the country's leaders, citizens, and international community react to the plan?
- What have been the effects of the plan to date?
- What direction has the country's economy taken since the crisis?
- What are the current strengths and weaknesses of the country's economy?
- Are there any ominous long-term problems in the country's economy?
- If problems currently exist in the country's economy, what are your prescriptions for solving them?

You may use all resources available for your research, provided that you credit these sources.

Feel free to use visual aids in your presentation (overheads transparencies, charts, graphs, slides, videos, etc.) if you feel that it would enhance your presentation. You will have 10 minutes to present your report to the class. Each member of your group must have an active, speaking role in the presentation.

APPENDIXES

GLOSSARY

appreciation—The increase in a currency's value

asset—A financial claim or piece of property that has value

autocratically—With undisputed power

balance of payments—A bookkeeping system for recording all the financial transactions between countries

balance of payments problem—A situation in which a country has failed to take in enough foreign money (gained from exports) to pay for what it imports from other countries

bank bust—A situation in which a bank goes out of business because it cannot pay its depositors and other creditors

Bank of Japan—Japan's central bank

bank supervision—The supervision of the way banks manage their reserves and conduct their lending and borrowing practices

bond—A financial contract that stipulates a specific repayment of principle plus interest on a loan at a given date in the future; a promise by a company or government to pay a certain amount of money to the person holding the bond on a fixed date in the future

bubble economy—A situation in which the prices of assets exceed their fundamental market values

business fixed investment—Investment by firms in physical capital, such as factories and equipment

capital—Factories, improvements to land, machinery and other tools, equipment, and structures used to produce goods and services

capital-saturated industry—An industry or particular sector of the economy characterized by excessive investment

capital inflows—The situation in which a country receives foreign investment in capital

capital outflows—The situation in which domestic investors lend money or invest outside the country or purchase foreign assets

central bank—The institution that oversees the banking system and is responsible for the amount of money and credit supplied in the economy; controls monetary policy to affect the economy

chaebols—A Korean term for corporate conglomerates in which a main firm owns numerous diversified subsidiaries

glossary

collateral—Property that is promised to the lender to guarantee payment in the event that the borrower is unable to make debt payments

competitive devaluation—The lowering of the value of one's currency to make exports cheaper and more competitive against similar goods produced in other countries

conglomerate—A firm that sells widely different types of products; also called a diversified firm

credit risk—The risk arising from the possibility that a borrower will default or fail to pay off a loan

creditor—One who lends money

crony capitalism—The practice of money-lending, contract-granting, and licensing based on close personal ties, rather than on assessment of credit history

currency—Paper money and coins

currency depreciation—A decrease in a currency's value

currency devaluation—The resetting of a currency at a lower fixed value

currency market—An arrangement by which exchanges in international currencies take place

current-account balance—A measure of a country's net exports of goods and services

current-account deficit—The amount spent on imports exceeds the revenues made from selling exports

current-account surplus—Revenues made from selling exports exceed the amount spent on imports

dead-end sectors—Areas in the market that fail to produce returns on investment; money-losing business projects

debt—Money that is owed to the lender

default risk—The chance that a borrower will be unable to make interest payments or pay off the original amount borrowed

deficit—A situation in which spending exceeds the amount of money received as revenue

deflation—A decrease in the overall price level

depreciation—A decrease in a currency's value

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glossary

deregulation—The process by which government-owned companies and financial institutions are privatized (sold to private investors)

diversify—To invest in securities of different industries in order to spread out or minimize the risk of possible losses

exchange rate—The price of a country's currency in terms of another

exports—The sale of goods and services abroad

Extended Arrangement—The IMF's method of providing a troubled member a line of credit for three to four years to support its reform programs

financial crisis—A major disruption in financial markets that is often characterized by sharp declines in asset prices and the failures of many financial and non-financial firms

financial intermediary—A firm that channels money from savers to investors by accepting deposits and making loans

financial globalization—The dramatic increase in free capital flows across the world; international investors lend money to or invest in companies in many different countries

fiscal policy—The government's plans for spending, taxing, and borrowing

fixed exchange rate—An arrangement in which a country's central bank keeps its exchange rate fixed at a certain level

float—To allow the exchange rate to be determined by the market

floating exchange rate—An arrangement that allows the marketplace to determine the price of foreign money

G-7 (Group of Seven)—The seven largest world economic powers: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States

gold standard—An exchange rate regime under which a currency is directly convertible into gold

gross domestic product (GDP)—The measure of the value of all the newly produced goods and services in an economy during a specific period of time; real GDP is the value adjusted for inflation

imports—The purchase of goods and services from abroad

inflation—The continual rise in price level

insolvent—A situation in which a firm or bank has gone bankrupt

glossary

interest rate—The amount received per unit of currency loaned per year; usually expressed as a percentage of a loan

International Monetary Fund (IMF)—The international organization officially founded in 1945 by the Bretton Woods agreement, designed to help countries with balance of payments problems and to facilitate the smooth exchange of foreign currencies and international trade

inventory investment—A change in the stock of unsold store goods from one date to another

liquidity crisis—A situation in which firms and individuals cannot convert their assets into cash or find the money to repay their debts

macroeconomics—The branch of economics that examines the functions and problems of the economy as a whole; examines economic growth, inflation, unemployment, and economic fluctuations

managed float regime—The current international financial environment in which exchange rates fluctuate from day to day but central banks can still attempt to influence their countries' exchange rates by buying and selling currencies

microeconomics—The branch of economics that focuses on the individual parts of the economy, such as product markets or groups of people

monetary policy—The central bank's management of monetary supply and interest rates

monetary policy instruments—Tools such as interest rate and money supply, used by the central bank to respond to inflation, real GDP, or other measures of the economy

moral hazard—A situation in which the provision of insurance against risk encourages behavior that makes the risk more likely to occur

moral suasion—In the case of the IMF, it is the IMF's application of pressure rather than force to get its members to adhere to a policy.

non-transparent or opaque accounting practices—A situation in which financial transactions are unclear and/or sometimes kept off the company's account records or balance-sheets

normal good—A good for which demand increases when income rises and decreases when income falls

open market operations—The buying and selling of bonds in the open market

par value system—A currency regime in which exchange rates are fixed against the dollar and at an unchanging dollar price of gold

pegged exchange rate—The system in which a country fixes its exchange rate in relation to another country's currency

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perfectly competitive market—A market in which there are many firms selling the same product, there is free entry and exit, and no firm has the power to affect the market price of a good

portfolio—Investment in a collection of assets

privatization—A situation in which firms previously owned or managed by a government are placed under private management

profits—Total revenues minus total costs

real gross domestic product (real GDP)—the measure of the value of all the newly produced goods and services in an economy during a specific period of time, adjusted for inflation

recession—A decline in real GDP; a period of reduced economic activity

residential investment—Purchases of new houses and apartment buildings

short-term debts—Loans and other financial obligations that must be repaid within one year

speculation—The purchase or sale of assets in expectation of profiting from market fluctuations

speculator—One who bets on the fluctuations in the market in order to make a profit

Stand-By-Arrangement—The IMF's method of providing a troubled member a line of credit for one to two years to support its reform programs

stimulus package—A set of policies intended to increase economic activity

stock—A financial instrument that is a claim on the earnings and assets of a corporation

subsidy—A financial sum granted by the government to a company to assist a project deemed beneficial to the public

transparency (corporate/banking)—The availability of data and clarity of bank balance sheets, financial transactions, and accounting practices of firms

volatility—The degree to which an economic variable or asset price fluctuates over time

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